

DOCUMENTS

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No.

22nd May 1967
1 Jyaistha 1889

Hon'ble Shrimati Indira Gandhiji
Prime Minister
Government of India
New Delhi

Dear Madam,

On behalf of the Indian Banks' Association, of which all the large Indian commercial banks, except the State Bank of India, all medium-sized banks, including the State Bank Subsidiaries, and a majority of the small-sized banks are members, and of which I am the Chairman, I may kindly be allowed to make the following submissions to your good self and to the Government of India regarding the resolution passed by the Congress Working Committee a few days ago requesting the Government of India to implement the promise of the Congress Party in its Election Manifesto for extending social control over the commercial banking institutions.

The following brief enumeration of the powers given by the Banking Regulation Act to the Reserve Bank over the banks shows clearly that the powers are so extensive and comprehensive that there is hardly any scope for adding to them or for extending further the social control over banks:

- (a) It is authorized to determine the policy in relation to advances to be followed by banks generally or by any bank in particular;
- (b) It can give directives to banks either generally to all or to any one in particular regarding the purposes for which advances may be made, the margins to be kept and the rates of interest to be charged;
- (c) No bank can remit, without the prior approval of the Reserve Bank, any debt due to it by any of its directors or by any firm, company or individual in which any of its directors may be interested;
- (d) It can issue directives regarding the maximum amount of advances to, or guarantees that may be given on behalf of, any one company, firm, association of persons or individuals, by any bank;
- (e) It can remove the Chairman or any director or any employee of a bank, appoint its own nominee to take his place, dictate the terms and conditions of service of the chief executive and approve or disapprove of the person chosen for this position;
- (f) It is empowered to inspect a bank thoroughly and without previous notice and to order the bank to rectify actions which it considers unsound, unsafe or antisocial;
- (g) It is empowered to and does actually keep a close watch over the advances of large amounts made by banks and its prior consent has to be obtained for all advances of Rs 1 crore and over to any one borrower;
- (h) It is authorized to appoint observers to watch the affairs of any bank and to make periodic reports to the Reserve Bank regarding its working; and

- (i) It is empowered to issue directives to any bank in order to safeguard public interest and the interest of depositors and to secure the proper management and working of the bank.

In addition to the above powers given to the Reserve Bank, the Act requires the banks to disclose all their advances, secured or unsecured, to their directors, officers or to companies etc. in which they are interested. Further, the Act prohibits them from granting unsecured advances to any company in which the Chairman of the bank, appointed for a fixed term, is interested as Chairman or Managing Director or Managing Agent or director or partner of the managing agent of the company.

The annual reports of the Reserve Bank entitled 'Trend and Progress of Banking in India' and the numerous directives which it has been issuing to the banks from time to time for the purpose of ensuring their functioning on sound lines and in the interest of the nation show that the above powers of the Reserve Bank have not remained on paper, but have been and are being used by the Reserve Bank whenever thought necessary by it.

The chief reasons given for demanding increased social control over banks are two: (1) the banks in the private sector are neglecting the credit needs of the small industries, and (2) they do not finance agriculture. The assumption here is that, once the social control over banks is increased, small industries and agriculture will get bank credit liberally and progress faster. The experience of the Banks in the public sector shows that this assumption is incorrect.

Banks in the public sector were brought into being as a part of an ambitious integrated scheme for institutionalizing rural credit and relieving the farmers from the clutches of the usurious moneylenders and for giving a fillip to small industries. Although this part of the scheme has been in operation for more than a decade now, it has not made any significant progress. This is striking evidence of the immensity of the problem and of the limitations on what the commercial banks can do in this sphere, in spite of the best possible intentions and efforts.

The main handicap in lending to small industries lies in the difficulty of assessing the creditworthiness of individual borrowers and the economic viability of their activities. The risks that banks, whether in the private or public sector, can take, have to be consistent with considerations of safety and liquidity, because the banks are only the trustees of the people who keep their money with the banks. Despite this handicap, the banks in the private sector have, in recent years, been stepping up their advances to small industries and their record in this respect does not compare unfavourably with that of the State-owned banks. This is shown by the fact that the outstanding advances of scheduled banks, other than the chief Bank in the public sector, to small industries were Rs 55 crores at the end of March 1965 as against Rs 19 crores in the case of the chief Bank in the public sector.

In spite of these difficulties, there is now greater awareness among banks than before of the need to serve small industries. Several of them have established separate departments for this purpose and liberalized their lending procedures and techniques. They are endeavouring to accelerate progress in this direction.

As regards agriculture, banks are already financing, on a large scale, plantations run on a commercial basis and the marketing of agricultural produce, and will not

find it much difficult to increase this finance in the immediate future with the help of the Agricultural Refinance Corporation. They have also been subscribing liberally to the debentures issued by the Land Development (Mortgage) Banks. The real problem of financing agriculture is the provision of finance for the agricultural operations of millions of small individual farmers, the vast majority of whom are engaged in subsistence farming and are helplessly exposed to the vagaries of the monsoon. It has been estimated that there are more than 60 million agricultural households, the average size of the operational holding of a household being about six acres only. What is more, about 70 per cent of the households have landholdings below this average. Every thinking person can appreciate the great difficulties of banks, in the public and private sectors, whose resources are already fully stretched, in catering to the credit needs of this vast multitude spread over this large country. Increase in the social control over commercial banks is no solution to this problem. Nearly a third of commercial banking is already State-owned, but it has not been able to touch even the fringe of the problem so far.

Some of the best brains of India have given deep thought to this problem. They do not think that commercial banks can be of much use in this direction even if the social control over them is extended further, on account of their obligations to their depositors. Their opinion is that cooperative banks provide the best possible approach. This has been tried for nearly a decade now and some progress has been made, although at a considerable cost to the public. A good part of the loans provided through the cooperatives has not been repaid. The overdues in 1962-63 were as much as 22.5 per cent of the outstanding loans. Moreover, a large diversion of loans taken for productive purposes to non-productive purposes is a common feature. The best way to deal with the problem would be to improve, extend and strengthen the cooperative movement.

Another assumption, on which the demand for extending further social control over banks is made, is that economic power in the private commercial banking sector is concentrated in the hands of a few families, who have been managing to make the bulk of its finance available to themselves and their concerns. This is not correct, because the advances made by the banks to their directors or to the concerns in which they are interested form a very small proportion of the total advances of the banks. Moreover, these advances are granted openly, in the ordinary course of business, are disclosed in the balance sheets of the banks and are subject to the control of the Reserve Bank. Even the public sector Banks have not been able to eliminate them. Indeed, if a bank directorship were to be a disqualification for obtaining bank credit, no businessmen could become a bank director and the quality of the management of banks, whether in the public or private sectors, would be very poor.

The boards of directors of banks consist of men of eminence, who have made their mark in various fields, like industry, business and the professions. Their varied experience, mature judgement and insight into the working of different kinds of industry and trade are available to the banks, in the formulation of the policies and in the conduct of the business of the latter. They control the functioning of the banks and ensure that the latter are run on sound lines, in the interest of the depositors, the shareholders and the public.

The large amount of credit granted by the banks may create the impression that their boards of directors have vast powers. Actually, however, the boards dispose of a very small proportion of the applications for credit. All the other applications are dealt with by the managers of 6,400 branches of banks in the country, within limits allowed to them, administrative instructions issued to them by their head offices and directives issued by the Reserve Bank of India from time to time. Bank lending is highly individualistic and decentralized, because managers of branches have to process and sanction thousands of applications for credit every year in accordance with their intimate knowledge of local conditions and their judgement regarding the solvency and profit-earning capacity of the various kinds of business which they are financing.

With extensive controls wielded by the Government over capital issues, industrial production, distribution and prices, banks do not have much choice in determining the industries, for the development of which, they provide the finance. With planned development, the banks necessarily finance those industries which are encouraged by the Government. In this way, the banks promote the planned development of the country, as desired by the Government.

Finally, the Reserve Bank itself, which enjoys the confidence of the Government, has made it known publicly through its annual reports and the speeches of its Governor that the Indian banking system is now working on sound lines and in the interest of the nation and is giving an excellent account of itself.

For the reasons mentioned above, I submit most respectfully, for the kind consideration of your good self and the Union Government, that there is absolutely no case for extending further the social control over commercial banks. I request that a small delegation of the Indian Banks' Association may kindly be allowed to wait on your good self and the Hon'ble Finance Minister to enable it to explain the above considerations more fully.

Yours faithfully,
K.M.D. THACKERSEY
CHAIRMAN

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No. D.O.No.G.8-68

June 2, 1967
12 Jyaistha 1889 (S)

Dear Shri Morarji Desai,

A paper regarding the social control of the commercial banking system was recently forwarded by Anjaria to I.G. Patel. I have received since then Shiralkar's letter dated 18th May 1967, asking for our views on certain specific suggestions. This question was also discussed informally at the last meeting of our Central Board and I think that it will be useful, if I were to indicate our preliminary views on this subject at this stage.

2. Before doing so, I would like to make a brief reference to our earlier observations regarding nationalization. The case for the nationalization of the

commercial banks has been urged on the ground that in relation to the results which may be achieved, the cost is not considerable, and can easily be met from the dividend income or residual profits, which now accrue to the private shareholders. This assessment may not turn out to be quite correct. Even if it were true, however, that an investment for the purpose of acquiring all the banks at present will be justified, it is doubtful whether the Central Government can now find the resources, which may be needed for the acquisition of all the banks other than the State Bank of India and its subsidiaries. The diversion of funds to this extent by cutting down other expenditure will not be desirable. The cost of compensation in foreign exchange, on account of the exchange banks, in case they are also taken over, will also be heavy; and the wider repercussions of acquiring them cannot be ignored. The compensation, whether it is paid in cash immediately or at the end of any period, may, under certain circumstances, increase the volume of liquid funds in the economy; and it is by no means certain that the resources which are thus released will be usefully employed. The possibility of the loss of some deposits to the banking system, while alternative forms of investment like trading in real estate or speculation in commodities are available, or the risk that the constituents of banks may, in the event of nationalization, prefer to handle some of the transactions in cash, instead of through the banking system, thereby adding to the volume of unaccounted money, cannot also be overlooked. For these and other reasons, which have been already indicated more fully in our earlier detailed note, the nationalization of all the banks is not desirable, and is likely to hinder rather than help our economic growth and progress at the present stage.

3. I, however, understand that the present approach is that only some leading Indian commercial banks, and not the entire commercial banking system, should be nationalized. This will mean that the exchange banks will be allowed to continue as they are. This approach to the problem is, I think, even more unsatisfactory than complete nationalization. If the exchange banks are allowed to continue, there is bound to be a drift of business, especially in the port towns and other urban areas, from the Indian banks to the exchange banks. If the diversion of deposits and accounts (which may be due to several reasons like the services which the exchange banks may be in a position to offer, or the expectation that the secrecy of information in respect of accounts in this sector of banking will normally be respected) turns out to be substantial, there will be a recurring burden in foreign exchange, attributable to the profits, which may be made by the exchange banks on this additional volume of business. It is not desirable that we should incur this additional liability. It is not also advisable that we should expose the Indian banking system to the risk of the loss of its business to the exchange banks, thus reversing, in effect, our consistent policy over a number of years of strengthening the Indian banks vis-à-vis the foreign institutions.

4. Assuming that the decision which may finally be taken will not be in favour of nationalization, a somewhat more effective degree of control, having regard to the present objectives, can be considered. It has been alleged that the shareholding, at least in the case of some banks, is closely concentrated, that large loans and advances are made to favoured groups, and that the needs of vital sectors like small-scale

industry or agriculture tend to be neglected; and it has been pointed out that the quality of the service provided by the commercial banking system has to be improved very considerably. Some of this criticism may be exaggerated, but the allegations have not been entirely or in all cases baseless. Further, it is also necessary that promotional or development work to a much greater extent should be undertaken by our commercial banking system. Having regard to this, we might, perhaps, consider the question of some further changes in the law and also some other measures within the general framework of our control.

5. In our present set-up, the Chairman or Vice-Chairman of a bank exercises considerable influence over a bank's affairs, but the existing law does not provide for the same control over his appointment or re-appointment as in the case of managing directors and chief executive officers. An amendment of Section 35B of the Banking Regulation Act 1949 can, therefore, be promoted to provide for a Chairman or a Vice-Chairman to be appointed or re-appointed in future, only with the prior approval of the Reserve Bank. In order to ensure that those who are appointed to these key posts will, as far as possible, be independent persons with no active connection with business or industry, it may be provided that the Chairman or the Vice-Chairman should not be the director of any other company. It may also be provided, in addition, through an amendment of Section 20 of the Banking Regulation Act, that no unsecured loans can be granted to any company or concern, in which a Chairman or Vice-Chairman is interested in *any manner* (conformably to the provisions of the Companies Act 1956, a shareholding to the extent of 2 per cent or less in a borrowing company may, however, be ignored for this purpose).

6. Under Section 36AB of the Banking Regulation Act, 1949, the Reserve Bank has, at present, the power to appoint not more than five additional directors under certain conditions in the case of any banking company. This power can, however, be exercised only if the appointments are necessary in the interests of the banking company or its depositors. It is not clear whether an appointment on the Reserve Bank's own initiative, as in the parallel case of the nomination of directors under Section 408 of the Companies Act will be possible. If any clarificatory amendment is necessary to ensure that the Reserve Bank can appoint one or two directors as its own nominees, in the usual course, in the case of all the bigger commercial banks, Section 36AB may be suitably modified; and a policy decision to make such appointments in future may also be taken and announced for the information of the general public.

7. Any legal restriction on transfers of bank shares, with a view to preventing the concentration of ownership will result in dislocation and inconvenience, as the shares of the existing private banks are bought and sold on a much larger scale than in the case of the State-associated banks. This object can, however, be achieved indirectly to some extent by the prohibition, through an amendment of the law, of unsecured loans to all substantial shareholders, with shareholdings in value of more than 1 per cent of the total value of all the shares issued by a bank. It may also be provided that secured loans granted to such substantial shareholders should be disclosed in sufficient detail in the balance sheets.

8. There may be occasions, when it may be desirable to provide for an extra-

statutory special audit of particular transactions or accounts of a bank. An investigation of the accounts of any specified branch, or of the bank's dealings with certain borrowers or business groups, or of its investments or loans against specific securities may, for example, be necessary, and the extent to which the bank has been able to comply with the Reserve Bank's directions regarding selective credit controls or other matters may also have to be ascertained. The Reserve Bank's inspection machinery, at present, is not adequate for the purpose of undertaking these special investigations; and a regular audit by a qualified professional auditor of standing may, in any case, be preferable to an ad hoc inspection. Provision may, therefore, be made, in the case of all the banks, for a special audit to be undertaken, if necessary, at the instance of the Reserve Bank, but at the cost of the banks concerned.

9. According to the prescribed form of the balance sheet, banking companies are required to disclose the outstanding debts and the maximum total advances during the year, due from or granted to managers or officers or directors or the concerns in which they are interested. It may be useful, if the present provisions could be amplified, so as to require the banks to show separately, and in greater detail, particulars of loans and advances to concerns in which directors of the banks are interested, as managing directors, or as ordinary directors, or as shareholders, or as managing or ordinary partners. Particulars of secured advances to substantial shareholders, with shareholdings of more than 1 per cent, may also be required to be disclosed. It is not necessary to amend the law for this purpose, as the changes in the prescribed form of the balance sheet can be made by notification under Section 29(4) of the Banking Regulation Act.

10. I have considered carefully the question whether any directives should be given to the commercial banks to grant loans to small-scale industries or to agriculture up to any prescribed extent. The loans and advances, which may be sanctioned by a commercial bank to any particular sector, will depend on various considerations, such as the business potentialities of the area in which the bank operates, the demands of its various constituents and the extent of the credit risks which may be involved. Having regard to these considerations and also the depositors' interests, it is not practicable to issue any rigid or statutory direction. As far as small-scale industries are concerned, there is, however, a genuine need for increasing very substantially the promotional effort by the commercial banking system, particularly with a view to providing assistance to artisans, skilled workmen, trained engineering graduates and other individuals, who may need very small sums as clean loans, at least in the first instance, while they are building up their business. I propose to suggest to all the larger commercial banks that they should, like the State Bank of India, create development departments or cells, which, in coordination with the State Bank's own organization, can cater to the needs of small-scale industries under a liberalized scheme and that concessions similar to those provided by the State Bank should also be granted by the other banks. In order to facilitate the grant of loans by the commercial banks to the smaller individuals and establishments, our credit guarantee scheme for small-scale industries will however have to be decentralized; and clean loans of relatively small amounts may have to be guaranteed on a much larger scale. We are also tentatively of the view that the

benefit of protection, in the form of a guarantee cover, should be made available directly to the non-scheduled commercial banks, urban cooperative banks and the relatively well-managed non-banking financial companies, like loan offices and nidhis so that these institutions can play a much larger role than at present in the field of financing small industries. These institutions (which besides being localized and in intimate touch with the smaller borrowers also have the advantage of being able to operate on the basis of relatively small margins) can also be encouraged to obtain financial assistance from the commercial banking system, if necessary, against loans for productive purposes, which may be granted by them.

11. As regards agricultural credit, the urgent need, at present, is to provide for the establishment of the proposed agricultural credit corporations in the states, in which the cooperative credit structure has been proved to be inadequate. Our recommendations in this regard are still pending, and the bill, which will be necessary for this purpose, has not yet been introduced in Parliament. As far as commercial banks are concerned, they will, I feel, be in a position to supplement the assistance provided by the cooperative banking structure and by the agricultural credit corporations, by financing certain essential inputs like fertilizers, hybrid or other improved seeds and agricultural machinery and implements. In order to reduce the risks of lending for this purpose by the commercial banks, it may be desirable for us to formulate a scheme of guarantee or insurance, in respect of bills relating to the purchase and sale of these commodities. The benefit of protection under the guarantee or insurance scheme can be made available to commercial banks or other specified institutions. The scheme can be conveniently operated by the Reserve Bank, which may be granted the necessary authority for this purpose through an amendment of Section 17 (11A) of its statute. The size and volume of commercial banks' assistance for financing these essential inputs for increasing agricultural production can be coordinated, to the extent possible, with the working of the crop loan system.

12. The modification of the existing credit guarantee scheme for small-scale industries and the addition of a further guarantee scheme, in respect of self-liquidating bills relating to specified agricultural inputs, will enable the commercial banks to lend much larger sums to these neglected sectors. The Reserve Bank can, however, operate these schemes only as an agent of the Central Government, or of the State Governments, in case the financial responsibility for the existing or proposed guarantee schemes is passed on, in future, to the State Governments, in respect of loans or bills within their respective areas. Our ability to operate the guarantee schemes, without any great loss, and our inducement to the commercial banks or financial institutions to lend increased sums of money on the basis of these guarantees, will depend on the extent of the cooperation which we may be able to get from Government, and especially from the State Governments, which are vitally concerned with the development of these neglected sectors.

13. We have been encouraging commercial banks for the last two years to invest more in debentures of land mortgage banks. This process can be carried further and banks may be persuaded to extend their support not only to debentures of land mortgage banks but also to debentures issued by all financing institutions set up to assist agriculture and small industries. Such an approach is bound to result in

funds of commercial banks flowing to support agriculture and small industry on a much larger scale than hitherto.

14. I have mentioned earlier the need for improving the quality of the service provided by the commercial banks. While the changes suggested in the foregoing paragraphs, if they are brought into force, will to a large extent, improve the management of the commercial banks and make them more oriented to finance agriculture and small industry, it is not adequately realized that the initiative and enterprise of the management may often be set at nought by the lack of cooperation from the employees, and especially from the staff governed by the Industrial Disputes Act. It has been our experience that quite often the service to the customers has been disrupted, cheques have, from time to time, remained uncleared, demonstrations have been held in or near the premises of banks and in the case of one bank, even some propaganda against the bank, with a view to bringing its credit into disrepute, has carried on by its employees. It is our view that the opportunity afforded by any amendments relating to social control, which may now be promoted, should be utilized to bring about a certain amount of discipline in the personnel working in banks. For this purpose, it will be desirable to provide for the prohibition by law of gheraos and go slow methods, which take the form of the abandonment of work or disobedience of reasonable and lawful orders or demonstrations with a view to impeding the transaction of business or propaganda against the interests of the bank and other similar activities. If this view is accepted, we shall suggest a suitable new provision for this purpose, to be included in the Banking Regulation Act, 1949.

15. One or two suggestions have also been made in the present context regarding the Reserve Bank and the State Bank. The Central Board of the Reserve Bank already represents several varied interests; and businessmen and industrialists are actually in a minority on this Board. The only action, which can usefully be taken at this stage, so far as the Reserve Bank is concerned, is to abolish the Local Boards, which in the present set-up do not have much work to do. As regards the State Bank, an attempt should, I think, be made to ensure that in making future nominations to its various boards other interests besides business and industry are more adequately represented.

16. In making the proposals contained in this letter, as an alternative to complete or partial nationalization, we have taken into consideration the objectives, which are now intended to be served. Our proposals, if they are accepted and implemented, will effectively strengthen our control, having regard to these objectives. I understand that your intention is to appoint a special officer to examine this problem in somewhat greater detail and to make recommendations regarding the action to be taken. I hope that the comments and views expressed in this letter as well as the proposals which we have made will be taken into consideration, before Government arrives at any decision on the basis of the special officer's report.

Yours sincerely,
P.C. BHATTACHARYYA

Shri Morarji Desai
Deputy Prime Minister and Finance Minister
Government of India
New Delhi

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BOMBAY
August 4, 1967

My dear Prime Minister,

It was good to hear from you and to find that amidst all your other worries you could still find time to write not only to me but also to a young man who felt a little sore over the abrasive officialese of a letter from the Reserve Bank.

I have not yet had a chance of discussing with Morarjibhai all the points I had touched upon in the notes I had left with you. On coming to Bombay, I got more preoccupied and concerned with the immediate problem posed by the rising tide of unemployment, particularly in the engineering industry. It is my feeling that the deterioration in the law and order situation in Calcutta has to no small extent been due to retrenchment and lay off which became inevitable with the curtailment of Railway orders on which the bulk of engineering industries in the Calcutta area are heavily dependent. In Bombay too Chief Minister Naik tells me the retrenchment figure is already around 50,000. Fortunately, with better and firmer administration there have not been the same kind of disorderly manifestations here which we have witnessed in Calcutta. So when I was in Delhi last, in my talks with Secretaries and also with Morarjibhai, I concentrated on the way in which the recession could be halted. I was happy to find a good deal of responsiveness among my old colleagues and Morarjibhai also in his speech incorporated some of the suggestions I had made. I have since taken some follow-up action on the credit front with which Gadgil also agrees. However, I am still worried.

The measures which Government or the Reserve Bank take to arrest recessionary trends and to stimulate production and employment in the engineering industry must go hand in hand with a reduction, however small, in the prices of their products. While I have been talking in this strain to industry, a positive lead can only be given by Government. I know there are difficulties in the way of a price reduction. Industry argues that compared with the upsurge in agricultural prices and the price of raw materials, the price of manufactures has not gone up much. The increase in dearness allowance also makes it difficult for industry to take a cut in present prices. Nevertheless, I am convinced that some reduction in prices of engineering goods particularly is justified. This is an occasion when engineering industries in the public sector should set an example. I was a little unhappy about the reported statement of the Managing Director of Hindusthan Machine Tools that he could not afford to lower prices when his profits were down to 10 per cent! 10 per cent may be a low level of normal profits, but in the present state of the economy, working even without profits for a few months would not be a bad thing in my opinion.

How right you are when you say that everyone agrees about appointing the right men in the key posts in the public sector, but when it comes to implementation it is another matter. Can we not at least advertise rather boldly and prominently in the

Press that we are on the lookout for executives to fill key posts in the public sector? If people can write in confidence to Cabinet Secretary expressing their interest in taking up such assignments, we might be able to pick up some really good candidates.

Last time when I was in Delhi you were intervening in the Foreign Affairs debate and I did not wish to take up your time. If I happen to come after the Parliament Session, I shall inform Seshan in advance.

With regards,

Smt Indira Gandhi
Prime Minister
New Delhi

Yours sincerely,
L.K. JHA

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September 26, 1967

My dear Shiralkar,

Raman is carrying with him four copies (plus one for himself) of a Memorandum we have prepared on Social Control Vs Nationalization. We could not get ready today an Appendix in which we propose to deal with certain observations in Dr Panandiker's Report which we are unable to endorse. This Appendix will be forwarded to you tomorrow, but I would suggest that even if it does not reach you in time, you should not hold up the transmission of the main Memorandum to Paris. In the Memorandum, we have taken care to deal with some of Dr Panandiker's findings with which we are not in agreement. We have, however, done so without referring to the Report.

2. I would request you to kindly arrange and send at least one copy of our Memorandum to Governor along with any material you may send to Secretary. Governor would probably arrive in Paris at the same time as the other members of the Delegation.

3. You will observe that in respect of a few recommendations already accepted by Government, we have offered comments which would indicate the need for further consideration of certain aspects. With regard to the National Credit Council, although we have not elaborated the point in the Memorandum itself, the general opinion in the Bank seems to feel somewhat doubtful about the need for establishing a regularly constituted body for the purpose in view. It is felt that the Reserve Bank's consultation may have to include different interests at different times, so that a Council with a fixed composition may not allow for sufficient flexibility in the operation of credit policies. Further, discussions in an open forum may not always be an advantage. There is also the possibility of pressures developing to influence credit allocations in favour of particular sectors. I have personally found the idea of the Credit Council very attractive and useful but feel that the practical points raised above should also be given careful consideration.

4. I had a brief conversation with Dr Panandiker who has suggested that if any

summary of the Report is to be forwarded, a revised version should be prepared. You may like to entrust the job to him. The transmission of your material need not be held up on that account.

5. Perhaps a copy of the Note which was put up to Cabinet may be of use to Governor and Secretary in considering how the matter should be presented on this occasion.

6. We would appreciate if you could favour us with a copy of any revised note that you may be forwarding to Paris.

With kind regards,

Yours sincerely,
B.N. ADARKAR

Shri S.S. Shiralkar
Additional Secretary
Ministry of Finance
Department of Economic Affairs
Government of India
New Delhi

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D.O.No.G.8-311

BOMBAY
December 6, 1967

My dear Morarjibhai,

I have had occasion to see a draft of the Bill to introduce social control over banks. The draft will, of course, undergo many changes and improvements before it is submitted to you. However, there are two points of substance about which I feel I should write to you.

When you decided that a bank which misbehaves should be taken over, it was my impression that you wanted to see such a bank nationalized in the true sense of the term and that Government will take over the shares from the shareholders. The draft which I saw is in the nature of an extension of the existing powers to amalgamate one bank with another, so that nationalization would mean merger with the State Bank.

I do not feel happy about this. The State Bank is already a huge mammoth organization and it would not be very desirable to make it even bigger by merging any large bank with it. More important is the consideration that the power to nationalize and therefore the liability to pay compensation must rest with the Government and not with the Reserve Bank. It is one thing for the Reserve Bank to amalgamate a bank which is financially in a bad shape with a bigger bank in order to protect the interests of the depositors and without employing public funds in the operation; it would be quite a different thing for the Reserve Bank to undertake a nationalization operation and provide the resources for compensating the shareholders without Parliamentary scrutiny, control and approval.

The second point which I wanted to put to you is of a somewhat practical nature. In regard to the composition of the Boards, it is easy to provide in the law that

industrialists will be in a minority and that agricultural and small-scale interests would necessarily be represented. However, it is not easy to define all the categories of people who would be deemed to be eligible to serve as directors of a bank. No matter how large a list one would draw, it is always possible to come across other categories which would seem to be equally suitable for serving on a bank Board. The categories included in the draft which I saw were lawyers, economists, accountants and one or two others. There was no mention of engineers who can be very useful in appraising projects. The same could be said of chemists. Then again, can we say that an educationist or even a well-respected citizen who may not be a specialist of any kind has no place as a bank director? Can we also, by law, rule out people with a labour background?

The point of my driving at is that it is impossible in the law to define all categories of people who alone will be deemed to be eligible as bank directors. I think, the purpose you have in view will be better served without creating difficulties in practice if the law merely limited the representation of industrialists to a minority position and enjoined the representation of certain sectors which deserve priority, viz. agriculture and small-scale industry—to which I would also add exports. If we have these three elements represented, then banks will not continue to neglect them. In regard to the remaining members, if at all they are to be described in the law, it would suffice to say that they should possess knowledge and experience which will be useful to the bank in the transaction of its business. With such a formulation, the informal advice of Government and the Reserve Bank can ensure that the right type of Boards does come into existence and once the pattern has been set up, there should not be any difficulty in making banks adhere to it.

As both these are matters of substance rather than of drafting, I thought I would bring them to your notice so that you can give the necessary guidance to the people concerned.

Shri Morarji Desai
Deputy Prime Minister
Government of India
New Delhi

Yours sincerely,
L.K. JHA

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14 December 1967

THE STATEMENT IN PARLIAMENT BY THE DEPUTY PRIME MINISTER AND MINISTER OF FINANCE ON SOCIAL CONTROL OF BANKS

With your permission, Sir, I wish to make a statement outlining the major steps that the Government has decided upon to implement the decision to have an effective social control over banks. A good deal of concern has been expressed in recent months in this House and elsewhere about the functioning of commercial banks in the context of our economic and social objectives. Our fundamental aim,

within the framework of democratic socialism, is to regulate our social and economic life so as to attain the optimum growth rate for our economy and to prevent at the same time any monopolistic trend, the concentration of economic power and the misdirection of resources.

The banking system is an important intermediary through which the savings of the community are channelized and is a key constituent of our economic life. We are all sure that its policies and practices must serve the basic social and economic objectives. It is in this context that the Government took on hand an examination of the functioning of the banks with a view to taking such steps as might be necessary to achieve social control over banks. We had kept an open mind on this issue and examined the various alternatives, including nationalization, and have decided upon a set of measures which would fulfil the objective in the most effective manner.

I think, it would be appropriate, before detailing the measures, to analyse what is at the root of the public concern over the way the banks function. There have been persistent complaints that several priority sectors such as agriculture, small-scale industries and exports have not been receiving their due share of bank credit and that the bulk of the bank advances is diverted to industry, particularly to large and medium-scale industries and big and established business houses.

It is a fact that over the years a greater proportion or additional resources accruing to the banking system has gone to industry, but it has to be borne in mind that banks supply primarily their working capital requirements; and once an industrial unit has come into being, it would have been a waste of national resources, in an underdeveloped economy like ours where capital is so scarce, to deny it working capital requirements and stifle its growth.

Nevertheless, the importance of sectors like agriculture, small-scale industries and export cannot be overlooked, particularly from the point of view of the national income generation, the provision of employment opportunities, the decentralization of economic power and the earning of foreign exchange. This underlines the need for ensuring credit to all productive sectors of the economy within the framework of our planned economy.

This is the crux of the problem. The demand for bank credit from all productive sectors has been growing apace and will continue to increase further, both in range and depth, but bank deposits have been growing at a slower pace. The level of savings in our country, because of the poverty of the population, is low. While long-term measures are needed to stimulate a larger volume of savings and attract them to the banking system, it is important to ensure, in the immediate future, an equitable and purposeful distribution of credit, within the resources available, keeping in view the relative priorities of developmental needs.

It is against this background that doubts have been expressed whether the banking system, as it is at present owned, constituted and controlled, can be relied upon to discharge this responsibility. Historically, the banks in our country have been started by industrial and business houses and they have close traditional links with them. The boards of directors mainly consist of industrialists and businessmen; small-scale industries, agriculture and other sectors of our economic life hardly have any influence in the overall credit decisions taken by the banks.

A good proportion of advances is given to directors and the concerns in which they are interested. It is the Government's considered opinion—and I am sure the House will endorse this—that the link between a few industrial houses and banks has to be snapped or at least made ineffective, the exclusive orientation of the banks towards industry and business has to be changed, and the credit decision by the bank management must be made to conform to the priorities of our economic development.

It is in this context that many honourable members have supported the idea of nationalization of banks. It has been argued that the necessary orientation in the Banks' pattern of lending and investment cannot be brought about except through public ownership. As I have been explaining, the basic issues which require attention are to evolve appropriate guidelines for the bank management and to ensure their implementation by orienting their decision-making process.

It is the Government's considered opinion that a mere acquisition of banks would severely strain the administrative resources of the Government while leaving the basic issues untouched. What is of prime importance is to ensure that particular clients or groups of clients are not favoured in the matter of distribution of credit and whatever the character of the shareholding, its influence is neutralized in the constitution of the board of directors and in the actual credit decision taken at different levels of bank management. The social control scheme, as conceived and formulated, is built on this basic postulate.

As I have already explained, the first major requirement is to assess periodically the demand for bank credit and indicate the priorities for lending and investment between all sectors of the economy that require credit, in particular the priority sectors such as agriculture, small-scale industries and export. For this purpose, it has been decided to set up a high-level body at the all-India level to be called the National Credit Council consisting of the representatives from large-, medium- and small-scale industries, agriculture, cooperative sector, trade and bankers and professional groups such as economists, chartered accountants, etc.

The Minister of Finance will be the Chairman and the Governor of the Reserve Bank, the Vice-Chairman. The council will be a compact deliberative body, and its deliberations, particularly because of the association of different interest groups, will help the Government and the Reserve Bank in taking appropriate decisions on the budgeting and planning of overall credit. A Government resolution laying down the composition, the terms of reference and other allied matters will be laid on the table of the House shortly.

It has, however, to be ensured that the decisions on the monetary and credit policy formulated by the Reserve Bank, in the light of the deliberations of the council, are implemented by the commercial banks. I shall be introducing in Parliament within the next few days a Bill for conferring additional statutory powers on the Reserve Bank. The powers which have been conferred in the past from time to time on the Reserve Bank have been primarily conditioned by the objective of protecting the depositors' interest. The new powers which are now proposed to be conferred on the Reserve Bank are more positive and purposeful. I would prefer to confine myself only to the important provisions as honourable members would have an

adequate opportunity of discussing the various provisions of the Bill when they are taken up for consideration and I would welcome at that stage any constructive suggestions which they would have to make after studying the Bill.

The Bill provides for a major change in the management of a commercial bank. Each bank will have a full-time chairman who will be a professional banker and not an industrialist. The Reserve Bank will have the power to appoint its own nominee as chairman, if the bank's nominee is not acceptable to it and will also have the power to remove him, if the Reserve Bank considers it necessary. The board of directors of banks will be reconstituted and the majority of directors of the reconstituted boards will be non-industrialists and persons from sectors such as agriculture, small-scale industries, cooperatives and other persons whose knowledge and experience will be useful to the banking company. The Reserve Bank will have the power to appoint a director or observer on the board of a commercial bank. In the initial stages, these powers will be exercised only in the major banks with deposits of over Rs 25 crores and gradually over a period, these will be extended to all banks.

Another important provision of the law will be to prohibit all advances or guarantees to directors and the concerns in which they are interested as directors, partners, managers, employees or managing agents or substantial shareholders.

No person or group of persons would, therefore, be able, by reason of their being on the board of directors of the bank, to get any loan for themselves or their concerns. Honourable members have expressed genuine concern, on more than one occasion, that the directors of banks exercise an undue influence on bank managements in getting loan for themselves and their concerns. I am sure that this statutory prohibition will go a long way towards eliminating the influence of any dominant group or persons in getting loans for themselves or their concerns.

I understand that there is, in some banks, the practice of setting up local or advisory committees which scrutinize loan applications and make recommendations to the board; I should like to make it clear that it is our intention that the borrowers of a bank should not be represented even on such a local or advisory committee of the bank. This will be taken care of by the issue of a directive by the Reserve Bank.

Honourable members would be interested to know how our scheme of social control would apply to foreign banks. These banks are incorporated outside India and their affairs in India are looked after by a chief executive who is a professional banker in their employ. The provision regarding wholtime chairman and reconstitution of the board of directors would not apply in their case. However, each foreign bank would be expected to set up an advisory board, consisting of Indians and following more or less the same pattern as that prescribed for Indian banks. They would be expected to conduct their lending policies and practices in the light of the guidance of the advisory boards. I have had discussions with some foreign bankers, and they have readily agreed to fall in line with our wishes. Further details are being discussed by them with the Governor of the Reserve Bank.

I have no doubt that the measures outlined above will achieve the object in view. I do not, however, rule out recalcitrance on the part of an individual bank. If there is a persistent default by an individual bank in complying with the provisions of law or directives issued thereunder, or if it is felt that for the better provision of

banking facilities to particular sectors or particular areas, it is necessary to acquire the business of a particular institution, the Government would not hesitate to do so. Suitable provision is being made in the forthcoming Bill.

I am confident that there would be better planning of credit through the establishment of the National Credit Council and more effective institutional control over the decision-making apparatus of the banks. I would, however, like to utter a word of caution. The change in the orientation of the lending policies of the banks has to be gradual. Too sudden a change may disorganize the delicate economic mechanism. One should not, therefore, expect a miracle overnight.

This covers the short-term measures which I have in mind to achieve a reorientation of the outlook of the banking system. I would now come back to what I had mentioned earlier. It is the inadequate level of savings which is a matter of serious concern. All efforts have to be made to mobilize deposits from rural and semi-urban areas whose potentialities are yet to be fully tapped. It is, no doubt, true that the commercial banks, particularly the State Bank of India and its subsidiaries, have been carrying out a programme of branch expansion in rural and semi-urban areas. More vigorous efforts are, however, needed in this direction.

Perhaps, the long-term objective should be the development of the banking system on the lines of regional banks which would be not only in a better position to mobilize deposits in rural and semi-urban areas but will also be in a better position to assess and meet the needs of the small entrepreneurs and the agriculturists in these areas. Such a development cannot, however, take place in the short term and the advantages and disadvantages of a change in the structure of the banking system have to be carefully weighed. There are other areas which require attention. The operational efficiency of the banking system has to be improved and their working modernized. I propose to set up a commission to have a close look at these and other related matters which affect the development of the banking industry on right lines. The terms of reference of the commission, its composition and allied matters are being worked out and will be announced soon.

There is also the need for improving the technical expertise of the banking executives and instilling a sense of independence and integrity in the banking profession. To this end I am considering the setting up of a training institute at the highest level and a working group has been appointed to go into this matter and to make recommendations.

The Indian banking system has attained stability and strength over the last fifteen years. The banking system, as an integral part of the money market, has given a good account of itself. But its orientation and outlook have to be changed, and it has to function as an effective vehicle for the implementation of the monetary and credit policy of the Reserve Bank, whose primary purpose is to realize, with support from other areas of fiscal, industrial and economic policy, the broad economic and social objective inherent in our ideal of democratic socialism. I am confident that the implementation of the measures I have outlined will lead to a positive reorganization of the banking system on sound lines and enable it to fulfil the role that is required of it.

Indian Banks's Association
 17 Horniman Circle
 Bombay - 1
 No. 302

5th February, 1968

The Honourable Shri Morarji Desai
 Deputy Prime Minister and Finance Minister
 Government of India
 New Delhi - 1

Dear Sir,

THE BANKING LAWS (AMENDMENT) BILL, 1967

We have the honour to observe that most of the provisions of the Banking Laws (Amendment) Bill, 1967 (Bill No. 174 of 1967) introduced in Lok Sabha on 23rd December 1967 are in conformity with the conclusions arrived at, at the informal meetings of the representatives of our Association with you. In a few cases, however, the language of the Bill, as it is drafted, is at variance with the intentions or objects of the Bill and different from the conclusions arrived at, at the informal meetings with you. Moreover, certain other provisions of the Bill are such as to cause hardships in genuine cases. May we, therefore, kindly request you to have the following points considered again and the language of the Bill redrafted, or its substance altered suitably? We also submit respectfully to refer the Bill to a Select Committee so that these and other points could be considered by the Committee clause by clause and properly at length.

1. *Clause 5 of the Bill Substituting a new Section for Section 20 of the Principal Act*

- (a) The proposed Section 20(1) prohibits all loans or advances or guarantees (whether secured or unsecured) to any of the directors or to firms or companies in which any of the directors is interested in the specified manner (even as an employee), or in which he holds a substantial interest or to any individual in respect of whom such director is a partner or a guarantor.

A strict interpretation of this provision would give rise to various anomalies. Thus, a bank director cannot discount at any office of the bank even a cheque drawn by him on his own account at any other office of the bank where he may have a substantial credit balance, for, such discounting may amount to an 'advance' made by the bank to its director and constitute a contravention of the law.

Again, there are quite a few big industrial units which are either semi-Government concerns or have been set up by the Government, and which have on their Boards of directors persons possessing special qualifications and experience in industry, business and commerce. Such industrial units may enjoy various credit facilities from a number of banks simultaneously. It is quite probable that some of the directors of such industrial units may

also be directors of one or the other banks who are bankers to the Government company. According to the proposed Section, it would be obligatory for such persons to relinquish either their bank directorship or their company directorship. To take a specific instance, the case of Gujarat Fertilizer Corporation Ltd. may be cited. The Gujarat Government have a majority shareholding in this Corporation and it was at the desire expressed by the Gujarat Government that a number of leading industrialists were specifically invited to join the Board of the Corporation so as to give it the benefit of their business expertise, and to enable it to operate on strictly commercial and business lines. Because of the magnitude of its operations, a number of banks have issued or participated in issuing guarantees on behalf of the Corporation for a few crores of rupees in favour of the Japanese suppliers of machinery, and have extended or will be extending other banking facilities. Some of the directors of this Corporation also happen to be the directors of one or the other of the banks who have issued such guarantees. If the proposed Section becomes effective, it would necessarily mean that these persons shall, in the event of their retaining their seats on the Boards of banks, have to give up their directorships in the Corporation if the Corporation were to continue to enjoy the large guarantee facilities extended by the banks. Such a development would deprive the Corporation of their valuable expert guidance for which they were specially invited to join.

We would, therefore, request you to kindly consider our suggestion that ordinary, normal and genuine loans, overdrafts, cash credits, and guarantees to concerns in which directors of banks are interested or with which they are connected may be allowed so long as the interest of the banks' directors in such concerns is not substantial and so long as such facilities satisfy the usual credit appraisal standards of the banks. In other words, where the interest of any of the directors of banks in the borrowing concerns is only nominal, and where such facilities are normal and usual, banks may be allowed to grant them within such limits as may either be specified in the Section itself or within such limits as may be determined in each case by the Reserve Bank of India in its discretion.

We also suggest for your kind consideration that loans or advances may be allowed to be granted to directors of banks against the security of their own Fixed Deposits and the prohibition under Section 20(1) should not be applied to such loans or advances.

- (b) We would further suggest that loans or advances to or guarantees on behalf of certain classes of borrowers such as public sector undertakings, a bank's own subsidiary company (such as an Executor and Trustee Company which is bound to have common directors with the bank itself), small-scale industrial concerns, and non-profit making companies which are registered under Section 25 of the Companies Act should be exempted from the prohibition contained in the proposed new Section 20(1).
- (c) We wish to point out that while Sub-Section (1) of the proposed Section 20 refers to loans and advances, Sub-Sections (2), (3) and (4) refer only to loans.

It is suggested that for the sake of consistency and to avoid ambiguity or doubt in the construction of the Section, the reference should uniformly be to both loans and advances in all the Sub-Sections of the proposed Section.

- (d) As already pointed out, in paragraph (a) above, under the proposed Section, as drafted, even the purchase or discount of a director's cheque may be construed as an advance and may consequently come within the scope of the prohibition under this Section. Similarly, a doubt may arise whether there is an element of guarantee involved when a bank opens L/Cs on behalf of a director or a concern in which he is interested or with which he is connected. It is, therefore, suggested in order to avoid any doubt or ambiguity that the terms, 'loans', 'advances' and 'guarantees' should be defined in the proposed Bill, so that such facilities are excluded from the scope of the prohibition under this Section.
- (e) It had been agreed that the existing facilities or assistance to the directors of banks or to the concerns in which they are interested or with which they are connected would be allowed to continue for a period of three years. Sub-Section (2) of the proposed Section 20 and the relevant Note on clause also provide that where no period has been stipulated for the repayment of any loan, steps should be taken for the recovery within a period of three years from the date on which the provision is brought into force.

The wording of the Section, however, appears to suggest that renewals of or operations on the existing loans, overdrafts, cash credits, etc. may not be permitted within the stipulated period of three years. The renewals of guarantees, where such guarantees require annual or periodical renewal, are also specifically prohibited. We, therefore, suggest that in order to put the matter beyond doubt, Sub-Section (2) may please be redrafted so as to allow all the existing limits on loans, overdrafts, cash credits and guarantees to be renewed as and when they are due and/or to be continued, operated and drawn fully, until the stipulated period for the repayment of the loan or until the specified period of three years where no period has been stipulated for the repayment of the loan. Similarly, all guarantee limits sanctioned may also be allowed to be renewed or continued in the same way. We may point out in this connection that except in the case of term loans, it is the common practice of all banks to treat all their advances as repayable on demand. As a corollary, it is also the practice of all banks to review the conduct of loans and advances periodically in order to satisfy themselves that the accounts are being conducted satisfactorily, before renewing them. Similarly, guarantees which are of a periodical or recurring nature come up for review or renewal from time to time in the normal course of business.

In other words, it may kindly be clarified that the proposed Sub-Section (2) would not prevent reviews and renewals of all the existing limits or facilities at their present levels, or operations or withdrawals under the existing limits, during the specified period of three years from the date of commencement of this Sub-Section but would prevent only the grant of absolutely fresh limits or facilities or any enhancement in their present levels.

We also suggest that in suitable cases, where extra facilities, assistance or guarantees are required by such borrowers, the Reserve Bank may be authorized to permit at its discretion the limits to be increased. Likewise there may arise occasions where for reasons beyond anyone's control the amount of assistance, facilities or guarantees may have to be increased suddenly. Thus, for example, deferred payment guarantees on foreign imports may go up on account of devaluation or any other unforeseen developments. We suggest that in all such cases the provisions of this Section should not apply and the additional facilities, assistance or guarantees may be granted. There is another aspect of this question to which we would like to draw your kind attention. The provision in Sub-Section (2) regarding repayment within the stipulated period may cause difficulties where the repayment is by fixed instalments and one or more of the instalments are in default and the bank desires both in its interest, and in the interest of its customers to give additional time for repayment. In all such instances, the final repayment of the loan may go beyond the period originally stipulated. It is, therefore, submitted that a suitable amendment may please be made to Sub-Section (2) to include a provision to enable a bank to reschedule the instalment payments with the approval of the Reserve Bank of India. Similarly term loans sanctioned prior to the commencement of the Amendment Act may involve disbursements of unutilized portions thereof during the period of three years after such commencement and also after the expiry of the said period of three years. We therefore suggest that banks may kindly be permitted to make disbursements of such loans sanctioned prior to the commencement of the Amendment Act, at any time thereafter.

- (f) With reference to Sub-Section (2) a contingency may arise where a person, who is a director of a bank on the commencement of the said Amendment Act ceases by death, retirement, resignation or any other disabling reason to be a director either of the bank or of the company or to be a partner of the concern, firm or to hold substantial interest therein. We would suggest that the Sub-Section be amended to make it clear that in such a case the prohibition contained therein shall cease to apply thereafter and the loans, advances or guarantees will be allowed to continue or be renewed in the normal way. While this position seems to be implicit in the Sub-Section, a doubt has arisen whether the prohibition contained in the said Section has once been attracted, the same would continue when the circumstances which originally caused the said prohibition to be effective have ceased to exist. It is suggested that the said Sub-Section (2) may be suitably amended to prevent any doubt.

*2. Clause 3 of the Bill Inserting New Sections 10A and 10B in the Principal Act
Section 10A*

We presume that the word 'employee' in Sub-Section 2(b)(1) of Section 10A does not refer to persons obtaining a fee or a retainer for giving advice or providing consultation services.

Section 10B

- (a) We suggest that the proviso to Sub-Section (2) of Section 10B should be suitably altered so that no disqualification shall attach to the chairman of the Board of Directors of a banking company in the following cases also:
- (i) Where under the terms of contract of a loan or an advance the bank is authorized to nominate its representative on the Board of the borrowing company, in order to safeguard the interest of the bank.
 - (ii) Where the chairman of a bank is appointed a director of companies or corporations like the Industrial Finance Corporation, Industrial Development Bank of India, Unit Trust of India, Life Insurance Corporation of India or the Agricultural Finance Corporation proposed to be floated by scheduled banks, or such other institutions which may be approved by the Reserve Bank.
- (b) The disqualification contained in the proviso (c) to Sub-Section (4) of Section 10B is likely to operate rather harshly against the Chairman of the Board of Directors of a bank. As the provisions stand, he is disqualified if he has a substantial interest in any other company or firm. Thus, it will be difficult for the Chairman to hold any shares or interest, for example, in a small-scale industrial concern started or run even by any of his close relatives.

We, therefore, suggest that the above Sub-Section may be suitably redrafted. In case it is not possible for any reason to modify this Section as suggested above, we request that the definition of substantial interest in relation to chairman of a bank may partly be modified so that any share or interest of his spouse or minor child in a small-scale industrial concern does not amount to a disqualification for the chairman.

3. Clause 15 of the Bill Inserting a New Section 36 AD in the Principal Act

The Indian Banks' Association welcomes the intention of the Government to give protection to the banks against the obstruction of business or against indecent demonstration within or in front of bank offices. The Association, however, feels that the drafting of the Section is inconsistent with the intentions and objectives of the Section, namely to ensure that no inconvenience is caused to members of the public and that the creditworthiness of a bank is not affected. As the Section is drafted, it would still be possible to hold demonstrations and shout slogans within or in front of the premises of the banks as long as they are not indecent. Moreover, no cognizance of any obstruction or offence under this section would be taken by police or courts except on a complaint from the Reserve Bank of India.

It would be physically impossible for the Reserve Bank to certify whether any indecent demonstration or obstruction of business took place or not. Moreover, it would be extremely difficult for the Reserve Bank to prove an offence under this section in a court of law. In so far as the banks would not be able to move a Court without the intervention of the Reserve Bank of India, the managements would feel deprived of the remedy at present available to them. As the law stands today, it is open to a bank management to go directly to a Court and obtain an injunction

restraining its workmen from obstructing the business at its offices or holding demonstrations, etc. The proposed Sub-Section (3) in Clause 15 of the Bill appears to impinge on this remedy.

We, therefore, suggest that the wording of the proposed Section 36 AD may please be modified suitably so as to simplify the procedure for taking disciplinary action and to eliminate the necessity for a certificate from the Reserve Bank of India being obtained.

4. Clause 2(iii) of the Bill Inserting a New Definition of a Small-Scale Industrial Concern

The proposed definition of 'small-scale industrial concern' applies to a manufacturing or a processing industry, but does not apply to a small company or a firm carrying on any trade or commerce, because such a company or firm would not have any investment in plant or machinery.

We suggest that the scope of the definition should be expanded so that a small-scale business, trading company or a firm is also included within the definition of the small-scale industrial concern if its assets are within the prescribed limits.

5. Clause 3 of the Bill Inserting a New Section 10B in the Principal Act

We suggest that the proposed Section 10B may be suitably amended so as to provide that the Chairman of the Board of Directors of a bank, being in its whole-time employment, shall not be deemed to hold an office or place of profit under the Company within the meaning of Section 314 of the Companies Act, 1956.

We also suggest that the proposed Section 10B should further be suitably amended so as to provide that Section 309 of the Companies Act shall not be applicable to the determination of remuneration payable to the Chairman of a banking company. It should also be provided that such remuneration may be determined by the Board of Directors of the bank subject to the approval of the Reserve Bank of India.

We further suggest that Sub-Section (3) of the proposed Section 10B may be altered so as to provide that it will not apply in cases where the office of the Chairman and Managing Director is held by one and the same person.

6. Clause 8 of the Bill Amending Section 30 of the Principal Act

The proposed Sub-Section (1A) of Section 30 of the Principal Act requires previous approval of the Reserve Bank before appointing, re-appointing or removing any auditor or auditors. We suggest that the word 'previous' may be deleted from the above phrase, with a view to avoid any technical difficulty which may arise if previous approval of the Reserve Bank cannot for any reasons be obtained. We are advised that a subsequent approval would not remedy the defect in the original appointment, re-appointment or removal, if it was made without prior approval.

7. Clause 11 of the Bill Amending Section 35B of the Principal Act

We suggest that the words 'previous' recurring in the proposed clause (b) of Section 35B of the Principal Act may also be deleted for similar reasons as stated above.

8. *Clause 20 of the Bill Adding a New Section 55A to the Principal Act*

We would also suggest that specific powers may be given to the Reserve Bank in the proposed new Section 55A to give directions to do or ordering to be done for the purpose of removing any difficulty which may arise in giving effect to the provisions of the amending Bill. We are aware that the proposed Clause gives such powers to the Central Government. Since, however, all the difficulties which may arise after the proposed Bill becomes operative cannot be anticipated and since there may be delays if reference to Central Government is necessary in all such cases, it is essential that the Reserve Bank may be empowered as suggested above. We are of the view that it would help expedite disposal of concerned matters if such powers are given to the Reserve Bank.

The provisions of Section 53 of the Banking Regulation Act will not be very helpful for this purpose since they empower the Central Government on the recommendation of the Reserve Bank to declare by a Notification in the official Gazette that any or all of the provisions of this Act shall not apply to any banking company or any class of banking companies. What the banks are requesting in this paragraph is not an exemption from any of the provisions of the proposed Bill but a power to the Reserve Bank to remove the difficulties, if any, which may arise in practice when this Section comes into operation.

Yours faithfully,

KRISHNARAJ M.D. THACKERSEY
CHAIRMAN

8

CREDIT PLANNING—THE ISSUES

To assist the deliberations of the Council, this paper attempts to outline some of the important aspects of the problem of allocating bank credit so as to make it a more efficient instrument of development. The problem arises principally because of two reasons. First, there is an overall shortage of savings in the economy. Second, only a relatively small proportion of the total savings in the community come to financial institutions which can deploy them for productive and developmental purposes.

The principal tasks before the economy in the credit field are firstly to increase the flow of savings into the banking system, and secondly to ensure that the lending policies of the banking institutions are aligned to the requirements of production and development.

In the initial stages, the Reserve Bank's directions to banks regarding their advances were mainly intended to ensure that all lending was safe and free from any risks which would jeopardize the safety of the depositors' money. The main accent was on the nature of security against which bank advances were made and the kind of margins which should be fixed so as to minimize, if not eliminate, all risks. Over time, the purposes for which loans were sanctioned began to assume greater importance relatively than the nature of the security offered.

There have been three broad principles followed by the Reserve Bank in providing the general guidance that it does to the banking system. In the first place, banks have been asked to conduct their credit operations in such a way that the banking system remained healthy and the confidence of the depositors in it was not impaired. Secondly, from the point of view of maintaining stability in the economy, banks have been asked to see that their resources are not used for commodity hoarding and speculation. Whenever necessary, appropriate control measures have been used for the purpose. Thirdly, banks have been encouraged to allocate a reasonable share of their resources for such purposes as exports, small-scale industries, term finance for agriculture through appropriate cooperative institutions, and so on.

The instruments which the Reserve Bank uses for controlling credit either by limiting the volume of its expansion overall or by imposing restrictions on particular types of advances, for example, against specified commodities, are the conventional ones which most central banks use. Thus, a check on the overall volume of credit is maintained through what is called the net liquidity ratio system. The principle of this system is: the more a bank borrows from the Reserve Bank of India, the less its net liquidity and the higher the rate of interest it has to pay to the Reserve Bank. Penal rates are charged if the borrowing is in excess of its entitlement which is fixed from time to time. A watch is also kept on the credit–deposit ratio of individual banks so as to see that their credit operations bear a reasonable proportion to the deposits they are able to mobilize. Then, in regard to specific purposes, limits are imposed and margins prescribed. Through these devices, the use of banks' resources for commodity and share market speculation is checked and they become available for purposes which are considered to be more conducive to economic growth. More recently, certain devices have been introduced to stimulate the flow of bank credit to certain sectors which are judged to have a priority and to which the availability of bank credit needs special stimulation. These comprise mainly the offer of additional finance from the Reserve Bank at the Bank Rate or at concessional rates lower than the Bank Rate to those banks which enlarge their lending to the priority sectors and some relaxation in the liquidity requirements under the net liquidity system.

In operating the system of selective credit controls and giving guidance to the banking system in regard to priorities, the Reserve Bank has had the advantage through constant informal talks and consultations at various levels to know the minds of Government and the Planning authorities. Consultations with the users of credit have also been taking place. The Reserve Bank is also represented in various committees and conferences where problems relating to industry and trade are discussed either specifically in relation to particular sectors of the economy or from a wider angle. In addition, the Reserve Bank maintains a close and constant watch on developments which have a relevance to credit policy such as the trend of prices and production of individual commodities, the situation in the capital and money markets, developments in the export sector, the movement of principal imports, etc. Credit policy has to be responsive to seasonal and short-term factors. The Reserve Bank has been following the practice of having meetings with bankers at the beginning of what are known as busy season and slack season when the policy for

the coming months is discussed and settled. In addition, whenever changing conditions in the economy require, such meetings are called at other times as well. Further, the directives and guidelines given to banks are constantly under review and are modified from time to time as and when necessary.

With the establishment of the National Credit Council, there is, for the first time, a forum in which the long-term policy and the priorities in the credit field can be discussed jointly with representatives of the banking system including the cooperatives on the one hand and the main users of credit on the other. The deliberations of the Council should help in developing a long-term strategy for credit planning and priorities.

The long-term impact of selective credit controls operated by the Reserve Bank has been, as will be seen from the paper on 'Pattern of Bank Credit', to stimulate the flow of bank credit to industry which now occupies the first position with nearly two-third of the total bank credit being used by it. This position has been built up at the expense mainly of credit to trade as well as to individuals for their professional or personal activities. This change which has been a natural consequence of the desire to promote the industrial development of the country does raise a number of questions in the perspective of long-term planning. Some of these are briefly touched upon below.

Bank credit to agriculture remains at a very low figure of 2-3 per cent of the total even after including credit to plantations. The question, therefore, does arise whether in the context of the emphasis which is being laid on agriculture today and the greater requirements of finance for introducing modern techniques into agriculture this is at all a reasonable figure and in what way it could be changed. Before considering this question, it is necessary to appreciate why this is so. Several expert committees appointed in the past to examine the problem of providing cheap and adequate credit for agriculture had been of the view that the enormous number of cultivating units and the wide variations in the size and type of their operations made provisioning of credit to them a very difficult task for institutions like the commercial banks which had neither the expertise in these matters nor the resources in terms of manpower and deposits to provide credit to the general run of cultivators. It is in the light of the recommendations of such committees that the Reserve Bank had attempted to handle this problem through the cooperative credit system which has the advantages of a wide network and, therefore, knowledge of local conditions.

However, in the more recent past, the Reserve Bank has been encouraging commercial banks to take up agricultural financing with due regard to the following points. First, the major agency for this purpose should continue to be the cooperative mechanism. The commercial banks cannot be expected to have either the expertise or the resources on the scale that this mechanism has. At the same time, methods should be devised whereby commercial and the cooperative banking system can work closer together and supplement each other's resources. Thus, commercial banks could expand the area of their indirect financing of agriculture through subscriptions to the debentures floated by land mortgage banks. Second, the fact that industries producing inputs for agriculture such as fertilizer, farm implements, pesticides, etc. will become increasingly important suggests a fruitful line of activity

for these banks. They could be asked to allocate a share of their resources for financing the distribution of such inputs. Third, where the cooperative mechanism has remained weak or is in a moribund state, commercial banks could attempt to fill up the gap. The Council may wish to consider the direction in which commercial banks could expand their area of their assistance to agriculture.

Turning from agriculture to industry, although it has the lion's share of bank advances, the fact remains that there are complaints both about the inadequacy of bank credit for industry as a whole and also about certain special problems which particular industries face. It is obvious that to sustain a high and increasing rate of production, an increasing amount of credit should be available to industry. Moreover, our experience has shown that with the increase in the production of large machinery and other capital goods, the requirements of credit have increased far more than the increment in the value of production. This is because the time cycle for the production of capital goods is longer, often extending into years rather than months necessitating larger credits for longer periods. Furthermore, sales of capital goods, whether to domestic users or to users abroad, often require financing over a period. Furthermore, the general increase in prices in recent years as well as the depletion of internal resources in several industries have combined to raise the amount of credit needed by industry for working capital purposes and at the same time erode its borrowing capacity. The problem is particularly difficult for units in the medium- and small-sized range. In fact, it would be true to say that despite the increase in the share which industry has of total bank credit, industry is still not able to meet its full requirements of working capital out of credit available to it.

The overall shortage of credit for industry can only be met over time by measures of deposit mobilization and increase in the savings by the community. It would be difficult to increase the share of industry in the available supply of credit not only because, as discussed in earlier paragraphs, there are new needs in the agricultural sector to which priority must be given, but also because even from the point of view of industry itself, certain other sectors need special attention. The larger out-turn of cash crops like jute, cotton and oilseeds, which are the basic raw materials of some of our most important industries, calls for larger credits being made available to the farmer and the trader. Similarly, some increase in the volume of finance to the trader or to the ultimate consumer would also be necessary if the production of industry is to be lifted and not accumulated in its godowns. This factor has assumed special importance in the prevailing recessionary conditions which have hit so many industries. To put it differently, the growth of industry results not only in an increased demand for working capital but also for additional credit at a large number of other points outside industry but inevitably linked with it.

So we come back to the crux of the problem which is the inadequacy of resources with the banking system. While this underlines the need for having priorities, we have to recognize that a step-up of credit to any one sector of the economy would inevitably mean a shortfall somewhere else. It is highly unlikely that much by way of additional resources would become available by identifying areas of less essential employment of bank credit though clearly this process must continue. It may be more fruitful to concentrate on the deployment of the increased resources with the

banking system which accrue every year with the rise in deposits. Currently, they are growing at the rate of Rs 425–450 crores a year. On this basis, bank could lend out of their own resources at the rate of Rs 300–325 crores a year since banks have to maintain at least 28 per cent in the form of cash, balances with the Reserve Bank, and investments in approved securities. The questions that need consideration are how the rate of deposit increase can be augmented and how this increase should be distributed as between different sectors.

That agriculture should receive high priority goes without saying. Further, a part of this increase must go to industry because industrial production must continue to rise. But there would be a case to see that a higher proportion of these resources goes to industries which are judged to be more deserving from an economic or social point of view. Small-scale industries clearly deserve greater attention from the banks. Same is true of the export sector. The existing system of preferential credit recognizes the special priority accorded to these sectors. The question is whether any other special areas of preferential treatment within agriculture and industry can be identified.

It has to be remembered all the time, however, that a large increase in the allocation to any sector may create problems for others and there is something to be said for a gradual rather than a radical change. This consideration becomes particularly relevant when we take into account the fact that the capacity to absorb credit, which is an essential counterpart of the allocation of credit, cannot be built up overnight. A series of steps have to be taken to establish the requisite links to examine the economics of particular schemes or projects before allocated credit actually starts flowing for the purpose for which it is meant.

In considering the long-term priorities for credit the Council will doubtless recognize that short-term factors may necessitate departures from the norms which are set up. The amount of credit required by a sector may be affected by such factors as the growth of demand in the economy, the availability of raw materials, import licensing policies, the state of the capital market and the monetary and credit policies followed by the authorities. For example, in the recent past because the capital market was depressed, many industrial units had to turn to bank finance to complete their investment programme because they could not raise funds in the market. Similarly, the recessionary conditions affecting certain industries left them with rather high unsold stocks on hand for which again they had to rely on bank finance. In its actual operation, there would seem to be a clear need for flexibility rather than rigidity in the matter of credit allocations.

One of the difficulties of assessing the needs of credit of different sectors arises because the data which are available are inadequate. It will be seen from the papers on agricultural credit and financing small-scale industries that no satisfactory estimates of requirements exist. The Council may wish to devote some thought to the kind of material that should be before it in order that it may be better able to consider the credit needs of different sectors.

In the light of what has been stated in the foregoing paragraphs and in the other papers that have been circulated, the Council may wish to discuss the following issues:

- (a) What kind of steps should be taken to increase the flow of savings into the banking system so as to augment its resources and its ability to provide credit to the deserving sectors of the economy?
- (b) In what manner should the likely increase in bank resources be deployed in order to be of the maximum benefit to the economy?
- (c) Apart from allocations to broad categories such as industry, agriculture, small-scale industries, exports and the like, are there any specially deserving areas within these categories to which special attention and priority should be given?
- (d) What kind of data compilation should be taken in hand in order to enable the Council to give further consideration to these questions in future meetings?

8.3.1968

9

File No. F. 12/1/78-BO.I.

Government of India
 Ministry of Finance
 Department of Economic Affairs
 Banking Division
 BO.I. Section

Subject: Requisition for Files Regarding the Promulgation of the Banking Companies (Acquisition and Transfer of Undertakings) Ordinance and the Bill 1969
 Exercised from the Ministry of Law, Justice and Co., Affairs F.No. 2 (E) 169-L-I.

The Cabinet, at its meeting held at 5.30 p.m. on 19 July 1969, approved a proposal to promulgate an Ordinance to provide for the acquisition and transfer of the undertakings of certain banking companies in order to serve better the needs of development of the economy in conformity with national policy and objectives and for matters connected therewith or incidental thereto. A copy of the Summary for the Cabinet is placed below.

Since it is not possible to get the Ordinance printed at such a short notice, a typed copy thereof is placed on the file for the acting President's signature.

S.K. MAITRA
 JOINT SECRETARY TO THE
 GOVERNMENT OF INDIA
 MINISTRY OF LAW
 LEGISLATIVE DEPARTMENT
 I.G. PATEL
 19.7.1969

Special Secretary
 Deptt. of Economic Affairs
 Ministry of Finance

P.M.

INDIRA GANDHI
PRIME MINISTER AND
MINISTER OF FINANCE

V.V. GIRI
19.7.1969

DS(E) may kindly remove the asserted copy of the ordinance for safe custody.

DS(E)

21.7.1969

On Friday, the 18 July 1969, at about 4.30 p.m., Shri S. Banerjee, Joint Secretary to the Prime Minister, requested me over the phone to come to the Prime Minister's Secretariat. He further advised me to go there as unnoticed as possible and also advised me not to disclose to any body as to where I was going. I, therefore, went to the Prime Minister's Secretariat without telling anybody where I was going. When I reached there, Shri Banerjee took me to Shri P.H. Haksar, Secretary to the Prime Minister. Shri Haksar told me that the Prime Minister has directed that an Ordinance for the nationalization of certain banks should be drafted by me immediately. He also instructed me to keep the matter completely secret and told me that I should not disclose my movements to anyone. Pursuant to the advise of Shri Haksar, I went to Shri S.S. Shiralkar, Additional Secretary, Ministry of Finance. In the meantime, I came to know that the Law Minister wanted that I should see him. I, therefore, went to the Law Minister and the Law Minister told me that the Ordinance for the nationalization of banks should be drafted by me as quickly as possible. The Law Minister further told me that some draft has been prepared by the Minister of Finance and that I am required to vet that draft only. The Law Minister, however, directed me to show to him the draft, prepared by me as soon as the draft has been prepared. Thereafter, I discussed the matter with Shri L.K. Jha, Governor, Reserve Bank, Shri Bakshi, Deputy Governor, Reserve Bank, Dr I.G. Patel, Special Secretary, Minister of Finance, Shri S.S. Shiralkar, Additional Secretary, Ministry of Finance and Shri D.N. Ghosh, Deputy Secretary, Ministry of Finance. Neither any draft nor any other paper was produced before me by the Ministry of Finance. Only three criteria were indicated to me, namely: (1) foreign banks are not to be nationalized, (2) Indian banks having deposits of not less than Rs 50 crores on the last Friday of June 1969, should be nationalized, and (3) the compensation should be the value of the assets less the liabilities.

2. I wanted to prepare the draft in my office but I was not allowed to do so. I was required to sit in a room in the Governor's Flat in the Reserve Bank. I was told that Shri R.K. Seshadri, Executive Director, Reserve Bank has left Bombay by air and he will also assist me in preparing the draft. Since the whole matter was to be kept secret, my whereabouts were not disclosed to anyone, not even to the members of my family.

3. Initially, I prepared a draft for straight acquisition of the banking companies by the Central Government. But when the draft was prepared and typed, Shri

Seshadri, who had arrived by that time, indicated that if all the banks were vested in the Central Government, then the Central Government would be required to run all the banks' departments, but the Central Government was not in a position to do so. Thereupon, we began to discuss what should be the appropriate scheme of the proposed nationalization. After some discussion, it was decided to convert the existing banks into statutory corporations so that the assets and liabilities of the existing banks could be transferred to the statutory corporations after nationalization. This scheme was discussed with the Governor and the Deputy Governor of Reserve Bank, and after prolonged discussions both of them agreed that this was the only solution. It was past midnight when the said scheme was approved.

4. Shri L.K. Jha had very kindly lent the services of his Personal Secretary to me and Dr Patel had also lent the services of his Personal Assistant to me. I began to dictate to these two gentlemen alternately and the whole night was over before the draft could be finalized. In preparing the draft, I had initially followed the pattern of the Metal Corporation of India (Acquisition of Undertaking) Act, 1966, but Shri Seshadri, insisted on following the pattern of the State Bank of India Act. Accordingly, Clause 4 was changed. The first draft, as so prepared, was shown to the Law Minister at his residence in the morning of the 19th instant, and he very kindly approved the draft without making any change therein. Later on, the first draft was discussed at a meeting held in the room of Shri Haksar. Shri L.K. Jha, Shri Haksar, Shri Bakshi, Dr Patel, Shri Shiralkar, Shri Seshadri, Shri Ghosh and myself were present at the meeting. The draft, which was prepared by me, was approved with very minor verbal changes. Thereafter, the draft was discussed by the Prime Minister, with Shri L.K. Jha and the Law Minister. Initially, provision was made in the draft for the payment of compensation in cash. Prime Minister desired that provision should be made for the payment of compensation in securities. In this connection, a question arose as to whether payment of compensation could be made in securities. The Law Minister also raised a point that the compensation provided for in the draft was more liberal than the compensation provided in the State Bank of India Act, which provided for payment of compensation on the value of shares.

5. The draft was thereafter shown to the Attorney-General and the Attorney-General approved the draft as a whole. He, however, objected to the provisions of Clause 4, which were drafted on the model of the State Bank of India Act at the insistence of Shri Seshadri, and he also suggested that Sub-Clause (2) of Clause 8 should be omitted. The Attorney-General advised me to follow the pattern of the Metal Corporation of India (Acquisition of Undertaking) Act, 1966. Accordingly Clause 4, Clause 6, Clause 8 and the Second Schedule were amended and were drafted on the lines of the said Act.

I discussed with the Attorney-General, the matter with regard to the method of compensation and he expressed the opinion that payment of compensation in cash is not essential; compensation could be paid in marketable securities. He also expressed the view that since under the Banking Laws (Amendment) Act, 1968, compensation is required to be paid for the nationalization of smaller banks on the basis of the value of the assets less liabilities, a different principle for the payment of

compensation for the nationalization of bigger banks would be discriminatory. Hence, the provisions which have been made are in order. A copy of the opinion of the Attorney-General is placed on the file.

6. I have informed JS(A) about what has been stated above.

S.K. MAITRA
JOINT SECRETARY AND LEG. COUNSEL
21.7.1969

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Eastern Economist
RECORDS AND STATISTICS

February 20, 1970

RENATIONALIZATION OF 14 BANKS

The President, Mr V.V. Giri, promulgated an ordinance on 14 February, renationalizing the fourteen major Indian banks whose nationalization had been set aside by the verdict of the Supreme Court on February 10, 1970. The ordinance makes renationalization effective from July 19, 1969, and the chairmen of the nationalized banks have been re-appointed as custodians. Full text of the ordinance follows:

An Ordinance to provide for the acquisition and transfer of the undertakings of certain banking companies in order to serve better the needs of development of the economy in conformity with national policy and objectives and for matters connected therewith or incidental thereto.

Whereas Parliament is not in session and the President is satisfied that circumstances exist which render it necessary for him to take immediate action;

Now, therefore, in exercise of the powers conferred by clause (1) of article 123 of the Constitution, the President is pleased to promulgate the following Ordinance:

CHAPTER I

(1) This Ordinance may be called the Banking Companies (Acquisition and Transfer of Undertakings) Ordinance, 1970.

(2) The provisions of this Ordinance (except section 21, which shall come into force on the appointed day) shall be deemed to have come into force on the 19th day of July, 1969.

2. In this Ordinance, unless the context otherwise requires:

- (a) 'appointed day' means the date of promulgation of this Ordinance;
- (b) 'banking company' does not include a foreign company within the meaning of section 591 of the Companies Act, 1956;
- (c) 'commencement of this Ordinance' means the 19th day of July, 1969.
- (d) 'corresponding new bank' in relation to an existing bank, means the body corporate specified against such bank in column 2 of the First Schedule;
- (e) 'Custodian' means the person who becomes, or is appointed, a Custodian under section 7;

- (f) 'existing bank' means a banking company specified in column 1 of the First Schedule, being a company the deposits of which, as shown in the return as on the last Friday of June, 1969, furnished to the Reserve Bank under section 27 of the Banking Regulation Act, 1949, were not less than rupees fifty crores;
- (g) 'Schedule' means a Schedule to this Ordinance;
- (h) words and expressions used herein and not defined but defined in the Banking Regulation Act, 1949, have the meanings respectively assigned to them in that Act.

CHAPTER II

ESTABLISHMENT OF CORRESPONDING BANK

Transfer of the Undertaking of Existing Banks:

(1) On the commencement of this Ordinance, there shall be constituted such corresponding new banks as are specified in the First Schedule.

(2) The paid-up capital of every corresponding new bank constituted under sub-section (1) shall, until any provision is made in this behalf in any scheme made under section 9, be equal to the paid-up capital of the existing bank in relation to which it is the corresponding new bank.

(3) The entire capital of each corresponding new bank shall stand vested in, and allotted to, the Central Government.

(4) Every corresponding new bank shall be a body corporate with perpetual succession and a common seal with power, subject to the provisions of this Ordinance, to acquire, hold and dispose of property, and to contract, and may sue and be sued in its name.

(5) Every corresponding new bank shall carry on and transact the business of banking as defined in clause (b) of section 5 of the Banking Regulation Act, 1949, and may engage in one or more forms of business specified in sub-section (1) of section 6 of that Act.

(6) Every corresponding new bank shall establish a reserve fund to which shall be transferred the share premiums and the balance, if any, standing to the credit of the reserve fund of the existing bank in relation to which it is the corresponding new bank, and such further sums, if any, as may be transferred in accordance with the provisions of section 17 of the Banking Regulation Act, 1949.

4. On the commencement of this Ordinance, the undertaking of every existing bank shall be transferred to, and shall vest in, the corresponding new bank.

5. (1) The undertaking of each existing bank shall be deemed to include all assets, rights, powers, authorities and privileges and all property, movable and immovable, cash balances, reserve funds, investments and all other rights and interests arising out of such property as were immediately before the commencement of this Ordinance in the ownership, possession, power or control of the existing bank in relation to the undertaking, whether within or without India, and all books of accounts, registers, records and all other documents of whatever nature relating thereto and shall also be deemed to include all borrowings, liabilities (including contingent liabilities) and obligations of whatever kind then subsisting of the existing bank in relation to the undertaking.

(2) If, according to the laws of any country outside India, the provisions of this Ordinance by themselves are not effective to transfer or vest any asset or liability situated in that country which forms part of the undertaking of an existing bank to, or in, the corresponding new bank, the affairs of the existing bank in relation to such asset or liability shall, on and from the commencement of this Ordinance, stand entrusted to the chief executive officer for the time being of the corresponding new bank, and the chief executive officer may exercise all powers and do all such acts and things as may be exercised or done by the existing bank for the purpose of effectively transferring such assets and discharging such liabilities.

(3) The chief executive officer of the corresponding new bank shall, in exercise of the powers conferred on him by sub-section (2), take all such steps as may be required by the laws of any such country outside India for the purpose of effecting such transfer or vesting, and may either himself or through any person authorized by him in this behalf realize any asset and discharge any liability of the existing bank.

(4) Notwithstanding anything contained in sub-section (2), on the commencement of this Ordinance, no person shall make any claim or demand or take any proceeding in India against any existing bank or any person acting in its name or on its behalf except in so far as may be necessary for enforcing the provisions of this section or except in so far as it relates to any offence committed by such person.

(5) Unless otherwise expressly provided by this Ordinance, all contracts, deeds, bonds, agreements, powers of attorney, grants of legal representation and other instruments of whatever nature subsisting or having effect immediately before the commencement of this Ordinance and to which the existing bank is party or which are in favour of the existing bank shall be of as full force and effect against or in favour of the corresponding new bank, and may be enforced or acted upon as fully and effectually as if in the place of the existing bank the corresponding new bank had been a party thereto or as if they had been issued in favour of the corresponding new bank.

(6) If, on the date of commencement of this Ordinance, any suit, appeal or other proceeding or whatever nature is pending by or against the existing bank, the same shall not abate, be discontinued or be, in any way, prejudicially affected by reason of the transfer of the undertaking of the existing bank or of anything contained in this Ordinance but the suit, appeal or other proceedings may be continued, prosecuted and enforced by or against the corresponding new bank.

(7) Nothing in this Ordinance shall be construed as applying to the assets, rights, powers, authorities, privileges and property, movable and immovable, cash balances and investments in any country outside India (and other rights and interests arising out of such property) of any existing bank operating in that country if, under the laws in force in that country, it is not permissible for a banking company, owned or controlled by Government, to carry on the business of banking there.

CHAPTER III

PAYMENT OF COMPENSATION

6. (1) Every existing bank shall be given by the Central Government such

compensation in respect of the transfer under section 4, to the corresponding new bank of the undertaking of the existing bank as is specified against each such bank in the Second Schedule.

(2) The amount of compensation referred to in sub-section (1) shall be given to every existing bank, at its option:

- (a) in cash (to be paid by cheque drawn on the Reserve Bank) in three equal annual instalments, the amount of each instalment carrying interest at the rate of 4 per cent per annum from the commencement of this Ordinance, or
- (b) in saleable or otherwise transferable promissory notes or stock certificates of the Central Government issued and repayable at par, and maturing at the end of:
 - (i) ten years from the commencement of this Ordinance and carrying interest from such commencement at the rate of 4.5 per cent per annum, or
 - (ii) thirty years from the commencement of this Ordinance and carrying interest from such commencement at the rate of 5.5 per cent per annum, or
- (c) partly in cash (to be paid by cheque drawn on the Reserve Bank) and partly in such number of securities specified in item (i) or item (ii) or both, of clause (b), as may be required by the existing bank, or
- (d) partly in such number of securities specified in item (i) of clause (b) and partly in such number of securities specified in item (ii) of that clause, as may be required by the existing bank.

(3) The first of the three equal annual instalments referred to in clause (a) of sub-section (2) shall be paid, and the securities referred to in clause (b) of that sub-section shall be issued, within sixty days from the date of receipt by the Central Government of the option referred to in that sub-section, or where no such option has been exercised, from the latest date before which such option ought to have been exercised.

(4) The option referred to in sub-section (2) shall be exercised by every existing bank before the expiry of a period of three months from the appointed day (or within such further time), not exceeding three months, as the Central Government may, on the application of the existing bank, allow and the option so exercised shall be final and shall not be altered or rescinded after it has been exercised.

(5) Any existing bank which omits or fails to exercise the option referred to in sub-section (2), within the time specified in sub-section (4), shall be deemed to have opted for payment in securities, specified in item (i) of clause (b) of sub-section (2).

(6) Notwithstanding anything contained in this section, any existing bank may, before the expiry of three months from the appointed day or within such further time, not exceeding three months, as the Central Government may, on the application of the existing bank, allow make an application in writing to the Central Government for an interim payment of an amount equal to 75 per cent of the amount of the paid-up capital of such bank, as on the commencement of this Ordinance, indicating therein whether the payment is desired in cash or in securities specified in sub-section (2) or in both.

(7) The Central Government shall, within sixty days from the receipt of the application referred to in sub-section (6), make the interim payment to the existing bank in accordance with the option specified in such application.

(8) The interim payment made under sub-section (7) shall be set off against the total amount of the compensation payable to such existing bank under this Ordinance and the balance of the compensation remaining outstanding after such payment shall be given to the existing bank in accordance with the option exercised, or deemed to have been exercised, under sub-section (4) of sub-section (5), as the case may be:

Provided that where any part of the interim payment is obtained by an existing bank in cash, the payment so obtained shall be set off, in the first instance, against the first instalment of the cash payment referred to in sub-section (2), and in case the payment so obtained exceeds the amount of the first instalment, the excess amount shall be adjusted against the second instalment and the balance of such excess amount, if any, against the third instalment of the cash payment.

(9) Any payment purported to have been made to an existing bank under sub-section (3) of section 15 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1969, shall be deducted by the Central Government from the amount of the compensation due to such existing bank and the amount so deducted shall be paid by the Central Government to the corresponding new bank.

CHAPTER IV

MANAGEMENT OF CORRESPONDING NEW BANKS

7 (1) The head office of each corresponding new bank shall be at such place as the Central Government may, by notification in the Official Gazette, specify in this behalf, and, until any such place is so specified, shall be at such place at which the head office of the existing bank, in relation to which it is the corresponding new bank, is on the commencement of this Ordinance, located.

(2) The general superintendence, direction and management of the affairs and business of a corresponding new bank shall vest in a Board of Directors which shall be entitled to exercise all such powers and do all such acts and things as the corresponding new bank is authorized to exercise and do.

(3) (a) As soon as may be after the appointed day, the Central Government shall, in consultation with the Reserve Bank, constitute the first Board of Directors of a corresponding new bank consisting of not more than seven persons, to be appointed by the Central Government, and every Director so appointed shall hold office until the Board of Directors is constituted in accordance with the scheme made under section 9;

Provided that the Central Government may, if it is of opinion that it is necessary in the interests of the corresponding new bank so to do, remove a person from the membership of the first Board of Directors and appoint any other person in his place.

(b) Every member of the first Board of Directors (not being an officer of the Central Government or of the Reserve Bank) shall receive such remuneration as is equal to the remuneration which a member of the Board of Directors of the existing

bank was entitled to receive immediately before the commencement of this Ordinance.

(4) Until the first Board of Directors is appointed by the Central Government under sub-section (3), the general superintendence, direction and management of the affairs and business of a corresponding new bank shall vest in a Custodian, who shall be the chief executive officer of that bank and may exercise all power and do all acts and things as may be exercised or done by that bank.

(5) The Chairman of an existing bank holding office as such immediately before the commencement of this Ordinance, shall be the Custodian of the corresponding new bank and shall receive the same emoluments as he was receiving immediately before such commencement:

Provided that the Central Government may, if the Chairman of an existing bank declines to become, or to continue to function as, a Custodian of the corresponding new bank, or, if it is of opinion that it is necessary in the interests of the corresponding new bank so to do, appoint any other person as the Custodian of a corresponding new bank and the Custodian so appointed shall receive such emoluments as the Central Government may specify in this behalf.

(6) The Custodian shall hold office during the pleasure of the Central Government.

8. Every corresponding new bank shall, in the discharge of its functions, be guided by such directions in regard to matters of policy involving public interest as the Central Government may, after consultation with the Governor of the Reserve Bank, give.

9. (1) The Central Government may, after consultation with the Reserve Bank, make a scheme for carrying out the provisions of this Ordinance.

(2) In particular, and without prejudice to the generality of the foregoing power, the said scheme may provide for all or any of the following matters, namely:

- (a) the capital structure of the corresponding new bank, so however that the paid-up capital of any such bank shall not be in excess of rupees fifteen crores;
- (b) the constitution of the Board of Directors, by whatever name called, of the corresponding new bank and all such matters in connection therewith or incidental thereto as the Central Government may consider to be necessary or expedient;
- (c) the reconstitution of any corresponding new bank into two or more corporations, the amalgamation of any corresponding new bank with any other corresponding new bank or with another banking institution, the transfer of the whole or any part of the undertaking of a corresponding new bank to any other banking institution or the transfer of the whole or any part of the undertaking of any other banking institution to a corresponding new bank;
- (d) such incidental, consequential and supplemental matters as may be necessary to carry out the provisions of this Ordinance.

(3) Every Board of Directors of a corresponding new bank, constituted under any scheme made under sub-section (1), shall include:

- (a) representatives of the employees and depositors of such bank, and

(b) such other persons as may represent the interests of farmers, workers and artisans, to be elected or nominated in such manner as may be specified in the scheme.

(4) The Central Government may, after consultation with the Reserve Bank, make a scheme to amend or vary any scheme made under sub-section (1).

(5) Every scheme made by the Central Government under this Ordinance shall be laid, as soon as may be after it is made, before each House of Parliament while it is in session for a total period of thirty days which may be comprised in one session or in two successive sessions, and if, before the expiry of the session in which it is so laid or the session immediately following, both Houses agree in making any modification in the scheme or both Houses agree that the scheme should not be made, the scheme shall thereafter have effect only in such modified form or be of no effect, as the case may be so, however, that any such modification or annulment shall be without prejudice to the validity of anything previously done under that scheme.

CHAPTER V

MISCELLANEOUS

10. (1) Every corresponding new bank shall cause its books to be closed and balanced on the 31st day of December of each year and shall appoint, with the previous approval of the Reserve Bank, auditors for the audit of its accounts.

(2) Every auditor of a corresponding new bank shall be a person who is qualified to act as an auditor of a company under section 226 of the Companies Act, 1956, and shall receive such remuneration as the Reserve Bank may fix in consultation with the Central Government.

(3) Every auditor shall be supplied with a copy of the annual balance sheet and profit and loss account and a list of all books kept by the corresponding new bank, and it shall be the duty of the auditor to examine the balance sheet of and profit and loss account with the accounts and vouchers relating thereto, and in the performance of his duties, the auditor:

- (a) shall have, at all reasonable times, access to the books, accounts and other documents of the corresponding new bank,
- (b) may, at the expense of the corresponding new bank, employ accountants or other persons to assist him in investigating such accounts, and
- (c) may, in relation to such accounts, examine the custodian or any officer or employee of the corresponding new bank.

(4) Every auditor of a corresponding new bank shall make a report to the Central Government upon the annual balance sheet and accounts and in every such report shall state:

- (a) whether, in his opinion, the balance sheet is a full and fair balance sheet containing all the necessary particulars and is properly drawn up so as to exhibit a true and fair view of the affairs of the corresponding new bank, and in case he had called for any explanation or information, whether it has been given and whether it is satisfactory;
- (b) whether or not the transactions of the corresponding new bank, which have

come to his notice, have been within the powers of that bank;

- (c) whether or not the returns received from the offices and branches of the corresponding new bank have been found adequate for the purpose of his audit;
- (d) whether the profit and loss account shows a true balance of profit or loss for the period covered by such account; and
- (e) any other matter which he considers should be brought to the notice of the Central Government.

(5) The report of the auditor shall be verified, signed and transmitted to the Central Government in such manner as may be prescribed.

(6) The auditor shall also forward a copy of the audit report to the corresponding new bank and to the Reserve Bank.

(7) After making provision for bad and doubtful debts, depreciation in assets, contributions to staff and superannuation funds and all other matters for which provision is necessary under any law, or which are usually provided for by banking companies, a corresponding new bank shall transfer the balance of profits to the Central Government.

11. For the purpose of the Income Tax Act, 1961, every corresponding new bank shall be deemed to be an Indian company and a company in which the public are substantially interested.

12. (1) Every person holding office, immediately before the commencement of this Ordinance, as Chairman of an existing bank shall, if he becomes Custodian of the corresponding new bank, be deemed, on such commencement, to have vacated office as such Chairman.

(2) Save as otherwise provided in sub-section (1), all officers and other employees of an existing bank shall become, on the commencement of this Ordinance, officers and employees of the corresponding new bank and shall hold their offices or services in that bank on the same terms and conditions and with the same rights to pension, gratuity and other matters as would have been admissible to them if the undertaking of the existing bank had not been transferred to and vested in the corresponding new bank and continue to do so unless and until their employment in the corresponding new bank is terminated or until their remuneration, terms or conditions are duly altered by the corresponding new bank.

(3) For the persons who immediately before the commencement of this Ordinance were the trustees for any pension, provident, gratuity or other like fund constituted for the officers or other employees of an existing bank, there shall be substituted as trustees such persons as the Central Government may, by general or special order, specify.

(4) Notwithstanding anything contained in the Industrial Disputes Act, 1947, or in any other law for the time being in force, the transfer of the services of any officer or other employee from an existing bank to a corresponding new bank shall not entitle such officer or other employee to any compensation under this Ordinance or any other law for the time being in force and no such claim shall be entertained by any court, tribunal or other authority.

13. (1) Every corresponding new bank shall observe, except as otherwise required

by law, the practices and usages customary among bankers, and, in particular, it shall not divulge any information relating to or to the affairs of its constituents except in circumstances in which it is, in accordance with law or practices and usages customary among bankers, necessary or appropriate for the corresponding new bank to divulge such information.

(2) Every director, member of a local board or a committee, or auditor, adviser, officer or other employee of a corresponding new bank shall, before entering upon his duties, make a declaration of fidelity and secrecy in the form set out in the Third Schedule.

(3) Every Custodian of a corresponding new bank shall, as soon as possible, make a declaration of fidelity and secrecy in the form set out in the Third Schedule.

14. Every Custodian of a corresponding new bank shall be deemed to be a public servant for the purposes of Chapter IX of the Indian Penal Code.

15. (1) All acts done by the Custodian, acting in good faith, shall, notwithstanding any defect in his appointment or in the procedure, be valid.

(2) No act or proceeding of any Board of Directors or a local board or committee of a corresponding new bank shall be invalid merely on the ground of the existence of any vacancy in, or defect in the constitution of, such board or committee, as the case may be.

(3) All acts done by a person acting in good faith as a director or member of a local board or committee of a corresponding new bank shall be valid, notwithstanding that it may afterwards be discovered that this appointment was invalid by reason of any defect or disqualification or had terminated by virtue of any provision contained in any law for the time being in force:

Provided that nothing in this section shall be deemed to give validity to any act by a director or member of a local board or committee of a corresponding new bank after his appointment has been shown to the corresponding new bank to be invalid or to have terminated.

16. (1) Every Custodian of a corresponding new bank and every officer of the Central Government and of the Reserve Bank and every officer or other employee of a corresponding new bank, shall be indemnified by such bank against all losses and expenses incurred by him in or in relation to the discharge of his duties except such as have been caused by his own wilful act or default.

(2) A director or member of a local board or committee of a corresponding new bank shall not be responsible for any loss or expense caused to such bank by the insufficiency or deficiency of the value of, or title to, any property or security acquired or taken on behalf of the corresponding new bank, or by the insolvency or wrongful act of any customer or debtor, or by anything done in or in relation to the execution of the duties of his office, unless such loss, expense, insufficiency or deficiency was due to any wilful act or default on the part of such director or member.

17. Any reference to any existing bank in any law other than this Ordinance, or in any contract or other instrument shall, in so far as it relates to its undertaking which has been transferred by section 4, be construed as a reference to the corresponding new bank.

18. No provision of law relating to winding up of corporations shall apply to a

corresponding new bank and no corresponding new bank shall be placed in liquidation, save by order of the Central Government and in such manner as it may direct.

19. (1) The Board of Directors of a corresponding new bank may, after consultation with the Reserve Bank and with the previous sanction of the Central Government, make regulations, not inconsistent with the provisions of this Ordinance and any scheme made thereunder, to provide for all matters for which provision is expedient for the purpose of giving effect to the provisions of this Ordinance.

(2) In particular, and without prejudice to the generality of the foregoing power, the regulations may provide for all or any of the following matters, namely:

- (a) the powers, functions and duties of local boards and restrictions, conditions or limitations, if any, subject to which they may be exercised or performed, the formation and constitution of local committees and committees of local board including the number of members of any such committees, the powers, functions and duties of such committees, the holding of meetings of local committees and committees of local boards and conduct of business there at;
- (b) the manner in which the business of the local boards shall be transacted and the procedure in connection therewith;
- (c) the delegation of powers and functions of the board of directors of a corresponding new bank to the general manager, director, officer or other employee of that bank;
- (d) the conditions or limitations subject to which the corresponding new bank may appoint officers, advisers and other employees and fix their remuneration and other terms and conditions of service;
- (e) the duties and conduct of officers, advisers and other employees of the corresponding new bank;
- (f) the establishment and maintenance of superannuation, pension, provident or other funds for the benefit of officers or employees of the corresponding new bank or of the dependants of such officers or employees and the granting of superannuation allowances, annuities and pensions payable out of such funds;
- (g) the conduct and defence of legal proceedings by or against the corresponding new bank and the manner of signing pleadings;
- (h) the provision of a seal for the corresponding new bank and the manner and effect of its use;
- (i) the form and manner in which contracts binding on the corresponding new bank may be executed;
- (j) the conditions and the requirements subject to which loans or advances may be made or bills may be discounted or purchased by the corresponding new bank;
- (k) the persons or authorities who shall administer any pension, provident or other fund constituted for the benefit of officers or employees of the corresponding new bank or their dependants;
- (l) the preparation and submission of statements of programmes of activities

and financial statements of the corresponding new bank and the period for which and the time within which such statements and estimates are to be prepared and submitted; and

- (m) generally for the efficient conduct of the affairs of the corresponding new bank.

(3) Until any regulation is made under sub-section (1), the articles of association of the existing bank and every regulation, rule, bye-law or order made by the existing bank shall, if in force at the commencement of this Ordinance, be deemed to be the regulations made under sub-section (1) and shall have effect accordingly and any reference therein to any authority of the existing bank shall be deemed to be a reference to the corresponding authority of the corresponding new bank and until any such corresponding authority is constituted under this Ordinance, shall be deemed to refer to the Custodian.

20. (1) In the Banking Regulation Act, 1949:

- (a) in section 34A, in sub-section (3), for the words 'and any subsidiary bank', the words, figures and brackets 'a corresponding new bank constituted under section 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Ordinance, 1970, and any subsidiary bank' shall be substituted;
- (b) in section 36AD, in sub-section (3), for the words 'and any subsidiary bank', the words, figures and brackets 'a corresponding new bank constituted under section 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Ordinance, 1970, and any subsidiary bank' shall be substituted;
- (c) in section 51, for the words 'or any other banking institution, notified by the Central Government in this behalf, the words, figures and brackets 'or any corresponding new bank constituted under section 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Ordinance, 1970, or any other banking institution notified by the Central Government in this behalf' shall be substituted;
- (d) in the Fifth Schedule, in Part I of paragraph 1, in clause (e), the Explanations shall be deemed never to have been inserted.

(2) In the Industrial Disputes Act, 1947, in section 2, in clause (bb), for the words 'and any subsidiary bank', the words, figures and brackets 'a corresponding new bank constituted under section 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Ordinance, 1970, and any subsidiary bank' shall be substituted.

(3) In the Banking Companies (Legal Practitioners Clients Accounts) Act, 1949, in section 2, in clause (a) for the words 'and any subsidiary bank', the words, figures and brackets 'a corresponding new bank constituted under section 3 of the (Banking Companies Acquisition and Transfer of Undertakings) Ordinance, 1970, and any subsidiary bank' shall be substituted.

(4) In the Deposit Insurance Corporation Act, 1961,

(a) in section 2,

(i) after clause (e), the following clause shall be inserted, namely:

'(ee) 'corresponding new bank' means a corresponding new bank constituted

under section 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Ordinance, 1970;

(ii) in clause (g),

(e) for the words 'or a banking a company', the words 'a corresponding new bank or a banking company', and

(b) for the words 'with a banking company' the words "with a corresponding new bank or with a banking company"

shall be substituted;

(iii) in clause (i), after the words 'banking company', the words 'or a corresponding new bank' shall be inserted:

(c) section 13 shall be renumbered as sub-section (1) thereof and after sub-section (1) as so renumbered, the following sub-section shall be inserted, namely:

'(2) The provisions of clauses (a), (b), (c), (d) and (h) of sub-section (1) shall apply to a corresponding new bank as they apply to a banking company.'

(5) In the State Agricultural Credit Corporations Act, 1968,

(a) in section 2, after clause (i), the following clause shall be inserted, namely –
'(ii) "corresponding new bank" means a corresponding new bank constituted under section 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Ordinance, 1970',

(b) after the words 'subsidiary banks' or 'subsidiary bank', as the case may be, occurring in clause (d) of sub-section (3) of section 5, in clause (b) of section 9 and in the proviso to section 18, the words 'corresponding new banks' or 'corresponding new bank', as the case may be, shall be inserted.

21. (1) Notwithstanding any judgement, decree or order of any court or tribunal,

(a) any action taken, or purported to have been taken, or anything done, or purported to have been done, between the 19th day of July 1969, and the 10th day of February 1970, by any corresponding new bank purported to have been constituted under the Banking Companies (Acquisition and Transfer of Undertakings) Ordinance, 1969, or the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1969, or by any person purporting to act on behalf of such bank and any right, obligation or liability acquired or incurred, between the said dates, by or on behalf of such corresponding new bank shall be deemed to have been taken, done, acquired or incurred under the provisions of this Ordinance by or on behalf of the corresponding new bank constituted thereunder;

(b) any action taken, or purported to have been taken, or anything done, or purported to have been done, between the 10th day of February 1970, and the appointed day, by an existing bank or by any person acting on behalf of such bank, and any right, obligation or liability acquired or incurred, between the said dates, by or on behalf of such existing bank shall be deemed to have been taken, done, acquired or incurred under the provisions of this Ordinance by or on behalf of the corresponding new bank constituted thereunder.

(2) Any suit, appeal or other proceeding of whatever nature instituted on or after the 19th day of July 1969, by or against a corresponding new bank purported

to have been constituted by the Banking Companies (Acquisition and Transfer of Undertakings) Ordinance, 1969, or the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1969, shall not abate, be discontinued, or be, in any way, prejudicially affected by reason of the expiry of the said Ordinance or the invalidation of the said Act, as the case may be, but such suit, appeal or other proceeding may be continued, prosecuted and enforced by or against the corresponding new bank as if such suit, appeal or other proceeding had been instituted by or against the corresponding new bank constituted under this Ordinance.

THE FIRST SCHEDULE
(See sections 2, 3 and 4)

<i>Existing bank</i>	<i>Corresponding new bank</i>
<i>Column 1</i>	<i>Column 2</i>
The Central Bank of India Limited	Central Bank of India
The Bank of India Limited	Bank of India
The Punjab National Bank Limited	Punjab National Bank
The Bank of Baroda Limited	Bank of Baroda
The United Commercial Bank Limited	United Commercial Bank
Canara Bank Limited	Canara Bank
United Bank of India Limited	United Bank of India
Dena Bank Limited	Dena Bank
Syndicate Bank Limited	Syndicate Bank
The Union Bank of India Limited	Union Bank of India
Allahabad Bank Limited	Allahabad Bank
The Indian Bank Limited	Indian Bank
The Bank of Maharashtra Limited	Bank of Maharashtra
The Indian Overseas Bank Limited	Indian Overseas Bank

THE SECOND SCHEDULE
(See section 6)

<i>Name of existing bank</i>	<i>Amount of compensation</i> <i>(in lakhs of rupees)</i>
The Central Bank of India Limited	1750
The Bank of India Limited	1470
The Punjab National Bank Limited	1020
The Bank of Baroda Limited	840
The United Commercial Bank Limited	830
Canara Bank Limited	360
United Bank of India Limited	420
Dena Bank Limited	360
Syndicate Bank Limited	360

The Union Bank of India Limited	310
Allahabad Bank Limited	310
The Indian Bank Limited	230
The Bank of Maharashtra Limited	230
The Indian Overseas Bank Limited	250

THE THIRD SCHEDULE

(See sub-sections (2) and (3) of section 13)

DECLARATION OF FIDELITY AND SECRECY

I, do hereby declare that I will faithfully, truly and to the best of my skill and ability execute and perform the duties required of me as Custodian, Director, member of Local Board, member of Local Committee, auditor, adviser, officer or other employee (as the case may be) of the* and which property relate to the office or position in the said* held by me.

I further declare that I will not communicate or allow to be communicated to any person not legally entitled thereto any information relating to the affairs of the* or to the affairs of any person having any dealing with the* ; nor will I allow any such person to inspect or have access to any books or documents belonging to or in the possession of the* and relating to the business of the* or to the business of any person having any dealing with the*

V.V. GIRI
PRESIDENT
14.2.1970

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Eastern Economist
FROM THE PRESS GALLERY

April 3, 1970

RENATIONALIZATION OF BANKS BILL ADOPTED
Our Parliamentary Correspondent

New Delhi,
Saturday

With the Rajya Sabha's current session scheduled to end next week, the two Houses of Parliament this week rushed through the Banking Companies (Acquisition and Transfer of Undertakings) Bill which sought to renationalize the 14 major banks in the country. These banks with Rs 50 crores deposits or more had been first nationalized on 19 July last through an ordinance. This ordinance was replaced by an Act during the monsoon session of Parliament. But this Act could not stand the challenge in the Supreme Court. Following the judgement of the Supreme Court, striking down this legislation on 10 February, a new ordinance was issued on 14

*Name of corresponding new bank to be filled in.

February, in the light of the court's observations. The bill adopted this week replaced this second ordinance.

Politically Motivated

The discussion on the bill in both the Houses, which sat for late hours to adopt it, was quite lively. As could be expected, both the Swatantra Party and the Jana Sangh opposed the bill tooth and nail, alleging that the nationalization of banks was politically motivated. The other major points of criticism were: (i) keeping the foreign banks as well as Indian banks with deposits less than Rs 50 crores outside the purview of the bill; (ii) the compensation to be paid to the nationalized banking companies; and (iii) bank loans to political parties.

The keeping of the foreign and the smaller Indian banks outside the purview of the bill was strongly objected to, among others, by the members belonging to Congress-Opposition and the leftist groups. The Communists and the SSP members were prominent among those who wanted the compensation payable to the nationalized banking companies to be lowered. Banking loans to political parties were taken serious exception to primarily by the SSP and Congress-Opposition parties. While stressing the need for scaling down the quantum of compensation, several members urged that the right to property should be taken out of the fundamental rights by amending the Constitution. The spokesman of the DMK in the Lok Sabha, Mr Dandapani, pleaded that besides providing representation to employees, two nominees of state governments should be included in the Board of Directors of each of the nationalized banks. He also wanted freedom for state governments to launch and run regional banks.

Defending the bill stoutly, the Union Minister for Law, Mr P. Govinda Menon, who piloted it, did not accept any of the suggestions of the opposition members. The various amendments moved from the opposition benches were all rejected.

The foreign banks, Mr Menon said, had not been included in the purview of the bill solely because they provided specialized services for our external trade; he cited, in this connection, the services of the Bank of Netherlands in the diamond trade and those of the Japanese banks in the export of cotton. Further, the foreign banks, Mr Menon pointed out, assisted in raising foreign currency loans; they also helped Indian entrepreneurs in contacting parties overseas with a view to entering into technical collaboration arrangements. A third reason for not nationalizing them was the principle of reciprocity in international affairs. The Law Minister clarified that it was not the fear of any complication of an international character which had prompted the government to keep the foreign banks outside the scope of the bill.

Discrimination

Countering the plea for the nationalization of Indian banks with deposits below Rs 50 crores, Mr Menon stressed that first the present nationalization of 14 banks had to be stabilized. With the nationalization of these banks, nearly 87 per cent of the deposits with the banking system of the country would be controlled by the state banking institutions. The nationalization of the Indian banks left outside the scope

of the bill, Mr Menon further observed, however, could not be ruled out at some future day.

The plea of the opposition members that political parties should not be allowed to get loans from banks was turned down by the Law Minister on the ground that these loans did not amount to donations.

In regard to the compensation being paid to the nationalized banking companies—about Rs 87.18 crores—Mr Menon said that his amount was reasonable. All factors had been taken into account in fixing this compensation. These included the profits made by each bank, the profits a bank was expected to make if continued on the private sector and the net surplus it had.

In reply to a question whether the nationalized banking companies would be allowed to restart the banking business, if they wished, the Law Minister said that this was a matter to be taken up with the Reserve Bank.

Mr Menon gave an assurance that an integrated scheme of the measures to be taken by the Government following the adoption of the bill would be placed before Parliament for approval within six months.

Towards Social Justice

As a concession to the leftist supporters of the measure, the Law Minister announced that the government had decided to delete section 36A(d) from the Banking Regulation Act which curbed trade union activities inside the banking premises.

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25th January, 1967

My dear Panesh,

I am enclosing herewith a clipping from the *London Times* of the 23rd regarding: 'Canadian Rejection of US Protest on Bank'. From this, you will see even economically developed independent countries refuse to facilitate banking expansion in their territories. Contrary to that, for peculiar reasons, foreign banking and other service organizations claim it as their birthright to expand in developing countries like ours. Also, I am afraid, our authorities without deeper consideration and thought facilitate that. Anyway I thought I should bring this to your notice, particularly in the light of pressures that are exerted on you for permitting more branches of foreign banking companies in India.

More when we meet and with kindest regards and best wishes.

Yours sincerely,

C.H. BHABHA

Shri P.C. Bhattacharya

Governor

Reserve Bank of India

Bombay

Encl:

CANADIAN REJECTION OF US PROTEST ON BANK

From our own Correspondent, Ottawa, January 22

The Canadian Government has sent a carefully worded but firm reply to the State Department in Washington rejecting a stiff protest over Canada's refusal to allow the Mercantile Bank of Canada, a United States owned subsidiary, to expand its activities in this country.

The Americans claim that Ottawa has not played fair, and that the proposed restrictions on activities here are discriminating and retroactive. Ottawa does not agree.

Mr Mitchell Sharp, the Finance Minister, said in Vancouver that there was nothing unreasonable about what the Canadians had done. Furthermore, he did not think there would be any occasion for the United States to retaliate.

'The Government position', he said, 'was simply that it did not want anybody—foreigner or Canadian—to hold a dominating position in charter banking here. All we ask the Mercantile Bank to do is to operate as any Canadian bank is requested to do. And I consider this policy quite reasonable, considering Canadian conditions.'

US Suspicions

'The Government', he added, 'was not opposed to foreign investment in Canada. On the contrary, it was recognized that if Canada was to continue its rapid expansion it was going to need foreign capital.'

Already rumblings are being heard from the direction of Congress and Wall Street. What the Americans appear to be suspicious about is the sudden return of Mr Walter Gordon, the former Minister of Finance, to the Pearson Administration, particularly at this time. Mr Gordon, who is the high priest of economic nationalism, had been rejected by the Liberal Party convention last October when he put forward his theories.

'What is Gordon going to do?' the Americans ask. At the moment Mr Pearson has given his old friend only a Ministership without portfolio, but has hinted at better things to come and referred to him as a senior colleague.

Mr Gordon's first task, some observers believe, will be to prepare a White Paper on the extent of foreign ownership in this country. On the other hand, there is feeling that perhaps the Prime Minister would rather have him at his side than not knowing what his former Minister of Finance was up to.

There may well be a confrontation with the Americans on Tuesday when the Commons banking committee meets to look at the legislation which led to the protest by the State Department.

At the committee hearings, the Mercantile Bank will be represented by Mr James S. Rockefeller, chairman of the First National City Bank of New York, the parent company, and by Mr R.P. Macfadden, president of Mercantile.

Medical Supplies

Other sensitive areas of Canadian-American relations will be explored this week in the Commons and outside Parliament, particularly in respect of some aspects of America's Trading with the Enemy Act. There has been trouble in this field before

over United States legislation which in effect says that parent firms in the United States should be responsible for the conduct of foreign subsidiaries, and the observance of American laws. There are stiff penalties for infringements.

Questions have now been raised in the Commons over the refusal of American drug companies to allow Canadian subsidiaries to dispatch to Vietnam drugs and medical equipment paid for by American Quakers. Both the State Department and the Treasury in Washington have denied issuing any special directives to these parent drug houses. However, North Vietnam is regarded in American eyes as a prohibited area and the drugs, according to the Toronto Quakers who are organizing their dispatch through Canadian ports, are going to both sides in the war.

The New Democrats in the Commons have asked Mr Winters, the Trade Minister, if he was prepared to make representations to Washington that American corporations in this country were expected to act in accordance with Canadian laws and not in accordance with the laws of a foreign country.

Mr Winters said Washington was well aware of Ottawa's attitude and this matter of sovereignty was brought up in a 'forceful way' when Canadian Ministers met their Washington counterparts last year.

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OPENING OF BANK BRANCHES

In the recent past, the practice has been to allow banks to open two offices at places where banks are in existence provided they open one office in a place which has no banks at all. I believe that it is in the interests of everybody to encourage more banks being opened in smaller places and to slow down somewhat the expansion in urban areas. My reasons are the following:

- (a) It is only by opening banks in rural areas and areas where there are no banks at present that the banking habit can be really widespread;
- (b) With the large harvest in sight there will be much more money in the rural areas and it is only if the banks can attract this money that they can start financing agriculture in a big way;
- (c) The tendency for banks to open branches in a competitive spirit in urban centres have gone so far as to create a heavy concentration in cities like Bombay, Calcutta and Delhi. This is an expensive business. It means hiring or buying costly premises, paying high wages to employees and also encourages a certain amount of indiscipline which the bankers complain about.

In a recent speech to the bankers' club, I had suggested that there should be some slowing down of branch expansion in urban areas. Privately the bankers told me that they would welcome this so long as their competitors as well as foreign banks are also kept in check. So far as foreign banks are concerned, they are obliged to confine themselves to port towns only (including Delhi). Although this was meant to be a restrictive measure, it is for them something of a blessing because they operate only in the more profitable areas. My thinking at present is that so far as port towns

are concerned, we should stop all new branches except of banks which do not have a branch in a particular port town. This will enable smaller banks to get a foothold if they want to have one. Furthermore, in respect of foreign banks, while all of them will be under restraint, those few—Japanese, French and Dutch—which have only one or two branches in the country will be able to open one or two additional branches in ports where they do not have any branch.

At the same time we should encourage banks to go to smaller towns as well as the rural area and ensure that those who do the pioneering work in any area are not confronted with too much competition too soon.

I hope this will have D.P.M.'s broad approval. He may also wish to talk over this idea with the bankers when he meets them in Bombay.

L.K. JHA
25.8.1967

D.P.M.

Copy to D.G. (An.)

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No. B 9/1968

MEMORANDUM TO THE CENTRAL BOARD
Policy Regarding the Licensing of Branches of Commercial Banks
by the Reserve Bank of India

I. *Introduction*

The branch licensing policy of the Reserve Bank of India is based on the provisions of section 23 of the Banking Regulation Act, 1949, which lays down the criteria to be followed by the Bank for dealing with the requests of commercial banks to open new places of business (vide Annexure I). A procedure has been evolved within the framework of the aforesaid section for dealing with applications from banks for opening offices, with emphasis on development of banking facilities in the country in a well-regulated manner, in accordance with the decisions of the Central Board. The policy is being reviewed and modified by the Bank from time to time to meet the requirements of the changing conditions in the economy.

II. *Evolution of Branch Licensing Policy*

2. In order to accelerate the pace of deposit mobilization in keeping with the tempo of economic growth, a liberalized policy was adopted by the Reserve Bank towards the close of 1956 when it was decided that licensed banks may ordinarily be permitted to open branches unless there were adequate reasons against granting permission in individual cases. The policy was further liberalized in July 1959 when the Central Board decided that more latitude should be allowed to financially sound smaller banks (licensed and unlicensed) having a restricted area of operation to open offices in adjoining areas. Although, as a result of liberalization of the policy, the pace of branch expansion was accelerated, one of the main objectives of the policy, namely,

the extension of banking facilities to rural and semi-urban areas, was not fully achieved as the choice of centres for opening new offices was left entirely to the discretion of banks which were inclined to open branches in developed centres only and were reluctant to go to unbanked areas for fear of making losses.

3. With a view to extending banking facilities in a planned and systematic manner to areas which were deficient in or devoid of such facilities, the branch licensing policy was reviewed and modified in terms of the proposals approved by the Central Board in June 1962. Under the revised procedure, the banks were classified under three categories, viz., (i) all-India banks, (ii) large regional banks and (iii) small regional banks. In order to ensure that all these banks expanded their activities in a regulated manner and in the process of expansion of bigger banks, the financially sound smaller banks were not crowded out of existence, the geographical spheres of operation of each of the above three categories of banks were demarcated. A coordinated programme of branch expansion was initiated for the first time and all the Indian banks excluding the State Bank of India and its subsidiaries (which have their own programmes) were advised to formulate a programme for opening offices for a period of three years ended July 1965 and to secure the Bank's approval in advance. Each bank was encouraged to implement a balanced programme of expansion embracing areas devoid of banking facilities and suburban areas of urban centres, besides towns of commercial and industrial importance.

4. The policy was again reviewed in April 1965 and certain modifications were approved by the Central Board at their meeting held in May 1965; a copy of the Memorandum approved by the Board at that meeting was placed on the table for the information of the members. The same policy was broadly reiterated by the Central Board at their meeting held in June 1967.

III. Expansion Programmes of Commercial Banks in the Private Sector

5. The first expansion programme was followed by two more programmes of two years each, the latest of which is to end on the 31st July 1969. Under the current programme, emphasis has been laid on the opening of offices in rural and semi-urban areas with the main objective of mobilizing deposits in such areas. Accordingly, banks were urged to open more number of offices in these areas instead of concentrating in urban centres.

6. A statement showing the progress made by the banks in opening offices under the impetus of these expansion programmes is given in Annexure II. It will be seen therefrom that under the first expansion programme for three years ended in July 1965, 606 offices were opened by the participating banks of which 224 were at unbanked places, while under the second expansion programme for the two years ended in July 1967, 544 offices including 197 in unbanked centres were opened. Under the third expansion programme, 32 eligible banks have been allowed in all 547 offices in 424 centres of which 327 are at rural and semi-urban centres; of the offices at rural and semi-urban centres allowed, 243 are at unbanked places. Of these, the banks have so far opened 42 offices of which 39 are in rural and semi-urban areas.

IV. Modifications Proposed in the Existing Procedure

7. The present branch licensing policy came up for discussion at the first meeting of the National Credit Council following which certain proposals for revision were formulated and discussed at the meetings of the Ad Hoc Advisory Committee of Bankers and the Standing Committee of the National Credit Council. At these discussions, the consensus was in favour of simplifying the existing policy, particularly by discontinuing the present procedure whereby banks are required to indicate centres where they propose to open branches, two years in advance and such centres are initially approved or rejected by the Reserve Bank on a simple population criterion. There was also general agreement on the desirability of doing away with any reservation of areas for small banks except where there is evidence of readiness on the part of such banks to open branches in areas reserved for them.

8. It is proposed that, in future, the branch expansion policy may be guided by the following principles:

(1) Banks should arrange for a continuous study of the banking needs and potential of the various regions where they wish to extend their operations, and their branch expansion programmes should be based on such studies. Each bank should select particular areas for development after a careful consideration of all the relevant factors, and its expansion programme should indicate the reasons for such selection. Developed or developing areas where economic activity is already in full swing should not be the only areas which are considered suitable for opening of new branches. Other areas where banks can encourage local enterprise or development of local resources by actively offering their services should also be selected. Branch expansion should aim, not only at mobilization of deposits, but also at expansion of credit facilities. The larger all-India banks which, at present, have a low credit–deposit ratio in their rural and semi-urban operations should endeavour to improve the ratio by making larger credit available at their rural and semi-urban branches.

(2) The two-year programmes to be submitted by eligible banks to the Reserve Bank need not be in terms of particular centres selected in advance, but only in terms of the total number of branches to be opened by each bank, showing the distribution of the total number between different States, and between rural areas, semi-urban areas, urban areas, cities with a population of 1 million or more and port towns.

(3) During the current expansion programme, each eligible bank should aim at opening a number of branches which is at least one-third larger than the actual number of branches opened by it during the period of the second branch expansion programme.

(4) All-India banks and the large regional banks should include in their programme a reasonable number of branches (not less than 10 per cent of the total) to be opened in underdeveloped areas.

(5) At least 50 per cent of the total number of branches to be opened should be in rural and semi-urban areas.

(6) For the purpose of (5) above, places with a population up to 10,000 may be

regarded as 'rural' and those with a population between 10,000 and 100,000 as 'semi-urban'.

(7) At least 50 per cent of branches to be opened should be at unbanked centres.

(8) The present criterion of judging the adequacy or otherwise of the banking facilities available at a centre, viz., one branch for a population of 10,000, may continue.

(9) Within the overall programmes approved for individual banks on the basis of the principles set out in (1) to (7) above, eligible banks may apply to the Reserve Bank for allotment of individual centres, keeping in view the proportions to be observed by them between underdeveloped areas and other areas, between banked and unbanked centres and between rural and semi-urban areas on the one hand and urban areas on the other. To ensure steady progress, banks will be expected to indicate the number of centres which they propose to apply for in each quarter. On the basis of information available from the Reserve Bank and other sources regarding population and existing banking facilities, banks will be free to select centres of their choice where they find that there is scope for establishing additional banking facilities.

(10) Applications from eligible banks will be considered on 'first come, first served' basis in so far as they relate to centres with a population of more than 5,000 (excluding cities with a population of 1 million or more and port towns), where there is scope for establishment of additional banking facilities on the basis of one branch for every 10,000 of population.

(11) An allotment made on this basis will be subject to the condition that within a period of six months, the bank to whom a centre is allotted will take effective steps for the opening of a branch at that centre, including acquisition of land or the premises. If the bank fails to do so, the allotment will be cancelled and the centre will be available for allotment to another bank.

(12) A bank which fails to conform to the principles regarding the distribution of branches between the rural/semi-urban and urban areas and between banked and unbanked centres will be treated as ineligible for the benefits of the 'first come, first served' procedure.

(13) Applications with respect to the following categories of places will need detailed consideration and will, therefore, not be granted by the 'first come, first served' procedure.

- (a) Centres with a population of 5,000 or less, (These are regarded as suitable for cooperative banks and applications with respect to such centres will need examination in consultation with the Agricultural Credit Department.)
- (b) Cities with a population of 1 million or more and port towns, and
- (c) Centres where additional branches are proposed to be opened in spite of sufficient banking facilities being already available on the basis of one branch for every 10,000 of population. In considering such applications, due regard will be had to the commercial and industrial importance and potentialities of the places concerned.

(14) Information regarding centres allotted from time to time will be made available to banks at monthly intervals.

(15) Commercial banks will be expected not to apply for centres adequately served by cooperative banks, but to endeavour, wherever possible to utilize the services of cooperative banks as their agents.

(16) The existing policy of permitting foreign banks to open branches at port towns on a restricted scale will continue.

(17) Applications from the State Bank of India and its subsidiaries for opening branches on commercial considerations outside their branch expansion programmes will continue to be dealt with on the same basis as applications from other commercial banks.

9. Under the present procedure, applications from commercial banks except those from the State Bank of India, for opening offices in India are referred to the Local Boards for advice before permitting the banks to open new places of business. As this procedure entails some delay, it is proposed to refer to the Local Boards only applications for opening offices at centres now reserved for detailed consideration. The remaining cases will be disposed of without reference to the Local Boards, but subsequently reported to them and the Central Board. Applications for opening offices outside the country will continue to be referred to the Committee of the Central Board as at present. Once a centre is allotted in accordance with the revised policy and the bank has completed its preparations for the opening of a branch at that centre, the necessary license will be issued upon application without reference to the Local Board.

10. The above principles will be applied to the current branch expansion programme. The principles will be applied with due flexibility. They will be brought to the notice of banks for their guidance.

11. The Board is requested to pass the following resolution:

‘Resolved

That the proposals contained in the Deputy Governor’s Memorandum dated the 27th April 1968 on the policy regarding the licensing of branches of commercial banks be and are hereby approved.’

Reserve Bank of India
Central Office
Department of Banking Operations and Development
Bombay

Dated 27th April 1968
Vaisakha 7, 1890 (Saka)

DEPUTY GOVERNOR

15

D.O. No. DBOD. EFS. 2372/C.452-68

August 24, 1968

My dear Shiralkar,

Will you please refer to your D.O. Letter No. 3805-AS/68 dated 22 July 1968 asking for my comments on C.H. Bhabha’s note on operations of foreign banks in India?

2. The note raises a number of specific issues, but there also seems to be underlying it a somewhat general point relating to our whole attitude towards foreign banks in India. It seems desirable to me that we should have a clear sense of direction in regard to our attitude towards foreign banks, and it is only within the framework of a long-term policy that decisions on specific issues have to be taken.

3. It is, I think, quite possible to argue, and I am not sure that Shri Bhabha would not argue, that foreign banks are not necessary for our economy. Certainly if there had been no foreign banks in India today, we would not have felt it necessary to have them. However, there are foreign banks in India and, what is often overlooked, many Indian banks have branches abroad; we are also opening new branches overseas. On every previous occasion when policy in respect of foreign banks has been considered, we have come to the conclusion that while there is need to ensure a proper discipline in respect of their activities, we should not adopt a policy of squeezing them out. Even recently when the entire future of the banking system was in a sense being considered afresh, the view we took in respect of foreign banks was not that they should be told to pack up, but that they should bring in foreign exchange on a long-term basis to represent their capital contribution as it were. We also asked them to set up advisory boards and to otherwise gear themselves to comply with social control. The assessment we made on that occasion also brought out that one of the useful things these banks have been doing is to help raise foreign exchange for Indian enterprises, the most important being of course our national airline.

4. If we accept the policy of allowing foreign banks to operate in the country, then clearly we cannot freeze their operations. As the economy grows and as the banking system develops, they must increase their activities and participations though clearly not to the extent of the Indian banking system.

5. One of the restrictions on them is that they are allowed to open branches only in port towns. Shri Bhabha has argued that as accounts in port towns are more lucrative, this is in fact a blessing on foreign banks. I am not sure whether he would feel happier if foreign banks were asked like Indian banks to open branches in unbanked areas *pari passu* with branches in port towns: foreign banks may well welcome it. However, there are good reasons, some of them political, against a change in the status quo. Shri Bhabha's impression that licenses to foreign banks to open new branches are being given liberally and without adequate scrutiny is not borne out by the facts. Since 1962, against 91 applications submitted by 9 foreign banks out of 13, we have permitted only 43 offices; during the same period, the number of new branches opened by Indian banks runs to 2367.

6. I am glad that you have already referred to the Centre Board of Direct Taxes the points regarding the revaluation of fixed assets and the increase in the depreciation cost. I hope you will forward their comments on these points to us in due course. Shri Bhabha's points about Head Office expenses are being looked into by the Department of Banking Operations and Development and the Exchange Control Department, and we shall write to you as soon as the necessary data have been collected.

7. Meanwhile, it will help us to know whether the basic assumption of our long-

term policy towards foreign banks as outlined above has the approval of Government. Once this is clear, then we would continue to maintain steady pressure on foreign banks to fall in line with our policies and expectations regarding their credit policies and the policy of Indianization, and see to it that they do not get any kind of an unfair advantage because of their foreign ownership.

Yours sincerely,
L.K. JHA

Shri S.S. Shiralkar
Additional Secretary
Ministry of Finance
Department of Economic Affairs
Government of India
New Delhi

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D.O.No.F.4 (58)–BC/68

Government of India
Ministry of Finance
Department of Economic Affairs
New Delhi
23 October 1968

My Dear Jha,

Please refer to your letter No. DBOD.EFS.2372/C.452–68 dated 24 August 1968 regarding your comments on C.H. Bhabha's note on operations of foreign banks in India. I am enclosing a copy of the reply which has been sent to Shri C.H. Bhabha by the Deputy Prime Minister.

2. We have taken this opportunity of reviewing our policy regarding operations of foreign banks in the light of Shri Bhabha's note and the observations which you have made thereon. On the whole, we feel that our policy of confining foreign banks to port towns would continue but even in port towns a more restrictive policy appears to be indicated. We find that, during the three years from 1965–67, 169 branches were opened by foreign and Indian banks out of which 22 were by foreign banks. It is true that Indian banks cannot complain that they have not got their due share of new branches in port towns, though on a branch-to-branch basis, the performance of foreign banks has been substantially better. We find, however, that, in a number of places, foreign banks have been allowed to open branches in residential localities. In Calcutta during 1966–67 as many as eight branches were allowed to be opened by foreign banks in areas which are mainly middle class residential localities. These areas are well served by Indian banks and we would perhaps have been justified in rejecting applications for the opening of branches by foreign banks in those areas. We consider that foreign banks should be authorized expansion in port towns in those cases where we are satisfied that their global affiliations would be of distinct advantage to our export–import trade or in the matter of availability of foreign exchange loans to Indian concerns. In other words,

our present policy will be further tightened and the opening of branches by foreign banks in residential areas, even in port towns would be restrictive.

3. Since our policy is to restrict the business of foreign banks, we should ensure that the direction issued by the Reserve Bank in April 1968 in respect of their credit–deposit ratios is complied with as speedily as possible. It appears that steps taken by the foreign banks to reduce the credit–deposit ratio have not, so far, been satisfactory. We hope that the Reserve Bank would pursue vigorously the policy of restricting their credit–deposit ratios within the overall direction issued in April 1968.

4. Arising out of Bhabha's note, there are two directions in which a close scrutiny by the Reserve Bank might be necessary. In the first place, the head office supervision charges will need to be carefully scrutinized. I am sure, as you have mentioned in paragraph 6 of your letter, the Reserve Bank is looking into this aspect and certain points which have occurred to us have also been communicated to the Reserve Bank separately. Secondly, it appears to us that it might be fruitful if a detailed study is made by the Reserve Bank regarding the level of profitability of different foreign banks. Some of the net profit figures for 1966 are interesting. The First National City Bank with a deposit of about Rs 48.8 crores earned a net profit of Rs 67.07 lakhs as against virtually the same amount of net profit earned by the National and Grindlays with deposits of Rs 175.94 crores. Bank of Tokyo with deposits of about Rs 7 crores earned a net profit of Rs 13.26 lakhs as against the Chartered Bank which earned virtually the same amount as net profit with deposits which are eight times as high. Some explanation, of course, can be readily suggested and part of the profits might come down with the decline in credit–deposit ratio. Nevertheless, it appears to us that a detailed study could profitably be made with a view to finding out whether any positive steps can be taken to reduce the volume of their repatriable profits.

5. In the end, I would make a special mention of the three American banks. We are inclined to think that transfers of US Government funds to the three banks, if they cannot be avoided, should preferably take the form of Cooley loans to these banks rather than general purpose deposits. These will come up for discussion separately with the Americans and we would be writing to you about this at the appropriate time.

Shri L.K. Jha
Governor
Reserve Bank
Bombay – 1

Yours sincerely,
S.S. SHIRALKAR

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3796-DPM/68

New Delhi
19th October, 1968

My dear Bhabha,

You would recall that some time back you sent me a note on the operations of foreign banks in India. The points you raised were important and I had them carefully examined in my Ministry.

You have referred in the first place to the branch licensing policy of the Reserve Bank in respect of foreign banks and seem to have an impression that licenses to foreign banks for opening new branches are not so meticulously reviewed as in the case of Indian banks. While we are allowing the foreign banks to function in India, we have restricted their operations to port towns, and, even within port towns, no undue bias was shown to foreign banks in the matter of opening new branches. I find that, during the three years 1965-67, the total number of branches opened in port towns by Indian and foreign banks were 169 out of which foreign banks opened 22 branches. I would assure you that the branch licensing policy in regard to foreign banks has been restrictive and will continue to be so.

You have referred in your note to the revaluation of fixed assets which has been carried out by some foreign banks in recent months and have expressed the fear that this revaluation has been done with the object of getting the benefit of additional non-taxable deduction through extra depreciation on the revalued assets. This apprehension is not correct. Depreciation under the Indian Income Tax is allowed on the written down value of assets (namely, the actual cost of the assets to the assessee less depreciation actually allowed in previous years). Thus, even after the revaluation of assets, the banks will not be able to claim any advantage in the matter of depreciation admissible under the Income Tax Act. Also I had it further examined whether revaluation would give the banks any advantage in the matter of Surtax. Here again I find that the position has been fully protected under the rules and the reserves brought into existence by increasing, by revaluation or otherwise, the book value of assets would not be taken as capital for the purpose of Surtax Act.

You have rightly pointed out that the amount of head office supervision charges by the foreign banks should merit a close scrutiny. I have asked the Reserve Bank to look into all aspects regarding the appropriateness of the scale of such head office supervision charges and I am sure that whatever action is considered appropriate will be taken by the Reserve Bank.

As regards the operating losses by the foreign banks, it appears that three foreign banks incurred losses during 1967 but the loss cannot be stated to have resulted from higher debits on account of head office administrative charges. The losses are transferred to the head office and are not carried forward in the balance sheet. If any foreign bank chooses to carry forward the loss in any year without transferring them to their head offices, we have to think of necessary action at that stage but, as I have mentioned, no foreign bank has done it so far and, for the present, I would prefer to leave it at that. I also had it examined whether the loss can be adjusted by a foreign bank by utilizing the balance in the capital reserve account on account of

revaluation of assets. This will not be allowed and the Reserve Bank would be advising the foreign banks to that effect.

I hope I have broadly covered the main issues you have mentioned in your letter. I must say that I greatly appreciate the trouble you have taken in bringing to my notice such important issues regarding the operations of foreign banks in this country.

Shri C.H. Bhabha
Central Bank Building
Fort
Bombay – 1

Yours sincerely,
MORARJI DESAI

18

BRANCH LICENSING POLICY AND POPULATION CRITERION

D.G.(A) in his note dated the 28th September has raised a number of important questions relating to the use of the existing population criterion for branch licensing. To answer them adequately would require a considerable amount of work. However, even looking at the available data regarding the recent experience of growth of deposits at population centres of various size, certain useful indications can be obtained. I thought it would be useful at this stage to describe these:

- (i) In the Annual Survey of Debits to Deposit Accounts we get annual averages of month-end deposits for each scheduled bank branch as for the calendar year. The branches are classified according to seven population groups, namely, (a) population below 10,000, (b) between 10,000 and 30,000, (c) 30,000 and 50,000, (d) 50,000 and 1 lakh (e) 1 lakh and 5 lakhs (f) 5 lakhs and 10 lakhs and (g) 10 lakhs and over. In the case of the last group, figures are also available for the four major cities such as Bombay, Calcutta, Delhi and Madras. The population, it may be noted, is according to the last Census. This, of course, introduces some error in the classification. The coverage of the Survey has varied somewhat from year to year. However, from 1963 onwards the number of reporting offices are between 97 and 99 per cent of the total.
- (ii) The number of branches have increased in all the population groups during the period 1963–66 (for which data are available). Despite this, the average amount of deposits per office has also increased in all the groups. The following tables show this. There are, of course, variations in the rates of growth of the average deposit per office in the different groups. But the fact that the average has increased is significant. For if branch licensing were too liberal in any particular population group resulting in competition for the deposits, the average deposits per office should have declined in that group. This has not happened.
- (iii) This raises the question of what should be the criterion to distinguish wasteful competition from healthy competition for branch opening in any particular area. Of course, the criterion cannot be a simple one such as average deposit

per office. It will have to be based on some assumptions regarding what is a reasonable period for a branch to obtain that level of deposits which can be considered as a break-even point in the light of the cost of running an office in that locality. This suggests that the figures need to be studied further on an areawise basis. We have actually started a sample study of new branches opened in Calcutta and Bombay in the different areas of these two cities to find out what kind of impact they had on the nearby branches of other banks. Similar studies can be undertaken for either centres in the different population groups or areas in the different population groups. But I would not suggest that action should be held up pending results of these studies because even the available data are sufficient in my view to suggest that a liberalization of the present population criterion within some limits is quite safe. Under several population groups, the rate of increase of average deposit per office per year is more than 10 per cent. In the population group 10,000–30,000 for instance, increase in average deposit per office in 1966 over 1963 was as much as 57 per cent. In the next higher population group 30,000–50,000, we get an increase of nearly 50 per cent in the average deposit per office over the same period. In the population group 50,000 to 1 lakh, it was 77 per cent. Beyond this group, as one moves on to the larger cities, the rate of growth of average deposit per office itself comes down but one must remember that the average itself goes on increasing with the size of the cities. It is only in the population group below 10,000 that the rate has been very low—only 8 per cent in four years.

- (iv) It seems to me, therefore, that no great harm will come to the banking system by relaxing the population limit to 5,000 per office. So long as we ensure that the banks do open a sufficient number of branches in the unbanked areas, we could allow them to open branches on the basis of a population of 5,000 per bank office. Of course, we must be very strict about observance of this condition.
- (v) As far as the profitability of the branches is concerned, I think we could leave this to the banks themselves. If a bank does not expect to make profit in a particular locality in a city, it is not likely to open a branch there.

For consideration.

D.G.(A)

3.10.1968

In the course of the Meeting of the Bankers' Ad Hoc Committee held on 4 October 1968, D.G.(A) referred to one aspect of the Bank's branch licensing policy, namely, the Bank's sanction which at present is given for opening of 50 per cent of the new offices in banked areas if the other 50 per cent are opened in non-banked areas. A reference was made to the feeling expressed by the banks that enough scope was not given to them for branch expansion. It was, therefore, thought desirable to give more flexibility to the policy. The present norm was one office for 10,000 population. It was proposed to reduce it to one office for every 5,000. D.G.(A) wanted bankers

Average Deposits of Scheduled Commercial Banks
(in centres grouped according to population)

(Deposits in lakhs of Rs)

Population	1963		1964		1965		1966	
	Number of offices	Average deposit per office	Number of offices	Average deposit per office	Number of offices	Average deposit per office	Number of offices	Average deposit per office
1. Below 10,000	695	9.7	767	9.5	890	9.9	1034	10.5
2. Between 10,000 to 30,000	1153	11.9	1334	13.0	1428	14.9	1426	18.7
3. Between 30,000 and 50,000	537	21.7	577	25.2	582	28.8	591	32.5
4. Between 50,000 and 1 lakh	581	28.4	629	32.0	636	32.6	641	50.2
5. Between 1 lakh and 5 lakhs	879	44.4	977	46.7	1009	50.9	1046	61.0
6. Between 5 lakhs and 10 lakhs	238	63.0	272	63.3	280	70.8	289	72.0
7. 10 lakhs and over	781	128.9	878	134.9	924	140.0	950	146.7

NOTE: Deposit figures are averages of month-end outstandings.

SOURCE: Survey of Debits to Deposit accounts.

Average Deposits of Scheduled Commercial Banks in the Major Cities

(Deposits in lakhs of Rs)

	1963		1964		1965		1966	
	Number of offices	Average deposit per office	Number of offices	Average deposit per office	Number of offices	Average deposit per office	Number of offices	Average deposit per office
Bombay	266	168.9	299	177.9	321	190.3	327	203.2
Calcutta	145	198.8	168	191.4	173	196.5	177	190.1
Delhi	173	97.1	195	111.9	199	107.4	205	122.3
Madras	134	44.7	143	43.6	148	52.6	150	53.9

NOTE: Deposit figures are averages of month-end outstandings.

SOURCE: Survey of Debits to Deposit accounts.

to consider whether it would be practicable for them to open offices in smaller centres.

There were two views expressed on this point. One view (expressed by Sarvashree Choksi, Pai and Laxminarayanan) was that the banks would welcome such a move. It was for them to choose areas which would be profitable for them. They thought that some competition was healthy for the growth of banking. The other view (expressed by Shri Gandhi) was that this would not be fair for the banks who had gone earlier in a particular region in that the fruits of the pioneering effort of their work would be reaped by other banks which came late in the field. Shri Ramanand Rao also strongly opposed the proposal to reduce the population criterion. On this, D.G.(A) referred to the study prepared by E.A. on 'Branch Licensing Policy and Population Criterion'.

Shri B.K. Dutt desired that further licensing should be stopped in particular areas which were overbanked. On this, there was some discussion on the criteria to be adopted for determining what could be considered as an overbanked area.

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BRANCH LICENSING POLICY—RELAXATION OF THE POPULATION CRITERION FROM 10,000 TO 5,000 PER BANK OFFICE

According to the existing procedure, in order to judge whether the banking facilities available at a place are adequate or not, the criterion of one bank office for every 10,000 of the population of the place is being followed. This criterion was adopted by the Reserve Bank as a rough guide soon after the passing of the Banking Regulation Act, 1949 and has been reiterated in the Deputy Governor's Memorandum No. B.9 which was approved by the Central Board at its meeting held on the 6th May 1968. It is, however, applied in practice with flexibility since the banking potential of a place is only partly dependent on the size of the population, and there are several other factors such as the economic development, the pattern of trade and industry, etc. of the place which also have to be taken into account. Moreover, in order to ensure that commercial and industrial centres are not deprived of adequate banking facilities, the above population criterion is relaxed and more bank offices are permitted wherever considered justifiable. Relaxations are also made in the case of the smaller banks which want to open branches in adjoining areas.

2. In the context of the present need for mobilization of deposits and the extension of banking facilities to all urban and semi-urban areas in the country which are devoid of or deficient in banking facilities, it is for consideration whether there should be a general relaxation of the population criterion from 10,000 to 5,000 per bank office. When the question was recently discussed in the Ad Hoc Committee of Bankers on the 4th October 1968, certain banks like the Central Bank of India, the Bank of India and the Bank of Baroda welcomed the proposal, whereas the State Bank of India and the Dena Bank opposed it as they felt that such liberalization might result in increasing the losses at their branches working in the smaller towns. In view of this and having regard to the general tendency of banks to open branches

in the bigger cities to the neglect of the smaller centres, it appears desirable to relax the population criterion on a selective basis, but not generally. A general relaxation, it is felt, may lead to further concentration of bank offices in the bigger cities and it would be difficult for us to resist requests of banks based on the new criterion, for opening offices in such centres. This may also lead to unhealthy competition between banks and may even result in diversion of business from existing banks. Further, there are about 500 places which are still underbanked even on the basis of the present population criterion and, if it is relaxed, the banks may not open offices at such centres in view of their general preference for bigger cities and other commercial centres. On the other hand, a policy of selective liberalization will enable us to allow suitable application of banks for opening branches even in the bigger cities, where there is ample scope for new deposits.

In view of the foregoing, it is suggested that the relaxation of the population criterion may be made on a selective basis as indicated below:

- (i) In centres with a population of over 5,000 but not exceeding 10,000 and served by an office of the State Bank of India or its subsidiaries, another bank office of a commercial bank in the private sector may be permitted where considered justifiable. Several complaints have been received that the services rendered by the State Bank of India and its subsidiaries are not adequate. Permitting an additional office of a commercial bank is likely to promote greater mobilization of deposits in such places.
- (ii) In places having a population exceeding 10,000 but below 5,00,000, the population criterion may be waived on a selective basis provided the banks do not locate their offices within a distance of 400 metres from the existing bank office. At present, the distance stipulation is insisted only in regard to the establishment of offices in residential and suburban areas of bigger cities.
- (iii) In regard to places with a population exceeding 5 lakhs and port towns, we may not generally relax the existing population criterion but allow, on merits, and on a larger scale than at present, applications of banks to open offices in newly developing localities depending upon their potentialities and the availability of banking facilities there or in the vicinity.

3. If the above proposal for selective liberalization of the population criterion is approved, a draft memorandum to the Board will be prepared accordingly. If, however, a general relaxation of the criterion is considered essential to mobilize deposits, a suitable draft memorandum will be put up recommending the necessary liberalization.

(C.O.)

17.10.1968

D.G. (Ad)

The proposal to reduce the population norm from 10,000 to 5,000 was warmly welcomed by all major banks except Dena and SBI. SBI's opposition is understandable, because the proposal would bring in a commercial bank at a place with 10,000 population where SBI has an office. But SBI would benefit by some competition. I think the modification suggested by CO(O) would substantially

achieve the purpose: we may relax the norm only at places below 5 lakhs. If approved, the proposal can be placed before the board.

BRANCH LICENSING POLICY—RELAXATION OF THE POPULATION CRITERION
FROM 10,000 TO 5,000 PER BANK OFFICE

Draft Memorandum to the Central Board is submitted for approval.

21.10.1968

C.O.(O)

D.G. (Ad)

Fair Memorandum to the Central Board is placed below for signature.

D.G.(Ad)

23.10.1968

110 copies of the Memorandum (45 copies on one side) are sent herewith.

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No. B. 31

MEMORANDUM TO THE CENTRAL BOARD
Policy Regarding the Licensing of Branches of Commercial Banks
by the Reserve Bank of India

The policy regarding the licensing of the branches of commercial banks by the Reserve Bank of India under section 23 of the Banking Regulation Act, 1949, was last reviewed by the Central Board at their meeting held on the 6th May 1968, when it was liberalized with a view to assisting banks to fulfil the targets set for them in the Third Branch Expansion Programme. It is proposed to consider in the present memorandum in what directions the policy could be further modified in the context of the current need for mobilizing more deposits and the extension of banking facilities to the urban and semi-urban areas in the country to the maximum extent possible.

2. One of the important criteria which is being followed by the Reserve Bank at present in granting licenses to open branches is the population basis of allowing one bank office for every 10,000 of the population. This criterion was adopted by the Reserve Bank in 1949 soon after the passing of the Banking Regulation Act. Since then, owing to the rise in the purchasing power of the people, there are many places having a population of about 10,000 which offer scope for more than one bank office. The present policy of not allowing more than one office in such places, except when a special case is made out by a bank, is probably having an inhibiting effect on the pace of branch expansion, since banks generally tend to avoid the trouble of exploring the banking potential of a place where an additional office would be permitted only if a special case could be made out. In order to encourage banks to open more branches, it is necessary to remove all formal impediments which may inhibit their efforts to mobilize deposits wherever such possibilities exist. Banks themselves, in their own interest, may be expected to avoid going to areas

which offer no scope for additional offices. In many places with a population up to 10,000 where the State Bank of India, or another commercial bank already has an office, the present policy is not to allow the branch of another bank to be opened. However, at many such centres, the opening of one more office may help more deposits to be mobilized through inter-bank competition which may lead to improvement in customer service as well.

3. Having regard to the foregoing considerations, it is proposed that the population norm per bank office be reduced from 10,000 to 5,000 in the case of centres with a population of below 5 lakhs, as indicated below.

- (a) In centres with a population of 5,000 but not exceeding 10,000 and served by an office of the State Bank of India, its subsidiary, or of a bank in the private sector, another office of a commercial bank may be permitted.
- (b) In places having a population exceeding 10,000 but below 5,00,000, the population criterion may also be reduced to 5,000 per bank office, provided the banks do not locate their new offices within a distance of 400 metres from an existing bank office. At present, the stipulation as regards the distance between bank offices is insisted upon only in respect of offices in residential and suburban areas of bigger cities. The existing practice of permitting opening of offices in banked centres in the ratio of one office in a banked centre to one office in an unbanked centre will continue to be in force, and this will check any tendency towards concentration in the banked centres.

4. The above modifications will be applied to the current branch expansion programme and will be brought to the notice of the banks for their guidance. The other criteria set out in memorandum No. B.9 dated the 27th April 1968 will continue to hold good.

5. The Board is requested to pass the following resolution:

‘Resolved

That the proposals contained in the Deputy Governor’s Memorandum dated the 23rd October 1968 regarding modification in the policy relating to the licensing of the branches of commercial banks be and are hereby approved.’

B.N. ADARKAR
Deputy Governor

Reserve Bank of India
Central Office
Department of Banking Operations and Development
Bombay, Dated 23rd October, 1968
Kartika 1, 1890 (Saka)

I have had more than one discussion with Shri Bakshi regarding the procedure to be adopted for dealing with applications for licenses under Section 23 of the Banking Regulation Act, 1949.

2. Shri Bakshi’s general feeling seems to be that:

- (i) the branch expansion programmes, judging by the evidence of the actual applications, is still heavily urban-oriented, particularly as the norms of 1:1 for urban and rural areas and 10 per cent for the opening of branches in centres with a population of less than 1,00,000 in the 7 underbanked States may not any longer be relevant, in view of the much greater emphasis on the opening of branches in rural areas and in these neglected States (if, as is likely, we are going to specify in future the actual places at which branches are to be opened in the light of the Nariman Committee's report after it is finalized, the ratios will, in any event, be meaningless);
- (ii) in view of the difficulties arising out of language barriers, long distances from the head offices, lack of familiarity on the part of senior officers at the head offices with local problems in remote areas and inadequate or unsuitable arrangements for transfers and postings to and from remote areas, the opening of branches by any nationalized bank other than the State Bank of India or its subsidiary, in a State or Union Territory in which it does not already have a fair concentration of offices should be discouraged (this will mean that the emphasis in future will be on branch expansion in three or four States, other than the State in which the bank has its head office or has the predominant number of offices);
- (iii) in the opening of branches, the claims of the smaller banks should not be overlooked, merely because they are not nationalized;
- (iv) the theory that a lead bank has to be given some preference, as compared with other banks, in the opening of branches, may easily lead to a monopoly of business for the lead bank in the allotted district and cannot, therefore, be accepted; and
- (v) subject to the above and subject to satisfactory performance in the opening of an adequate number of rural offices, in all the cities which have a cosmopolitan character, that is those with a population of 1 million and above or those which are otherwise known to be cosmopolitan, every bank should have an opportunity of opening an office on commercial consideration.

3. The Nariman Committee will shortly be finalizing its report. It will do so, after taking into consideration the 650 and odd treasury and sub-treasury centres which still remain to be covered under the proposals which have recently been made at the meeting of the ad-hoc committee of bankers and also the possibility of opening branches or sub or pay offices or satellite or mobile offices in schools, colleges, and factories. After the list of places to be covered has been finalized by the Nariman Committee, licences can automatically be given to every bank in respect of any place allotted to it according to the list.

4. The question of licensing will, thereafter, be relevant only for the opening of branches on purely commercial considerations outside the list as finalized by the Nariman Committee. Our licensing policy may be modified at this stage, so as to eliminate the present free for all system, which has led to a number of complaints, and some criteria for licensing can be drawn up, based on the considerations set out in paragraph 2 above.

5. The formal revision of our licensing policy may take some time. This matter will, in any case, have to be considered more fully at a later stage, after we have had some more experience of the working of the nationalized banks and before a clear and definite policy for the future is formulated. In the meantime, I have tried to point out the need (a) to clear pending and future applications as quickly as possible and (b) the need to allow complete freedom to the Reserve Bank to dispose of applications individually. Although we have consulted Government in regard to individual applications in one batch at their instance, in order to fix our ideas, it will not be practicable to continue this procedure as a standing arrangement, and it is not the intention that there should be individual consultations in future.

6. If Governor agrees, I shall follow this up with a letter to Shri Shiralkar explaining the position.

(The Nariman Committee's report cannot be deemed to be formal at this stage. Some details of the centres and districts involved are indicated in the folder below.)

R.K. SESHADRI

17.10.1969

22

This was handed to me by Governor. My comments are as follows:

Para 2(i): When Nariman Committees plan is approved and it is agreed to license all centres to banks as shown in that plan, no question arises of any '1:1' or '1:10' ratios being observed. (ii) When the Committee's work is completed, all 327 districts of India will have been allotted to banks by consent, subject to (as has been agreed) the interest evinced by small banks and then special position in particulars districts (e.g. Andhra Bank in Guntur for which Union Bank was, in the absence of that knowledge, mentioned as the Lead Bank) being taken into account. (iii) covered by comments on (ii); (iv) The concept of a district-wise credit plan, with the responsibility for formulation of such a plan being initially taken by a commercial bank, involving RBI, SBI, subsidiaries, other commercial and cooperative banks, etc. (i.e., to ensure that 'lead' does not mean dominance or 'monopoly') is the very core of the credit scheme presented in Prof. Godgil's Group's Report. The categorical statement in (iv) that this theory cannot be accepted will mean throwing this whole approach overboard. (v) The conclusion that every bank which fulfils its rural quota should be allowed 'on commercial consideration' to open an office in cities having a population of 1 m. or more, is a hasty one; it is here that there is overcrowding; it is this area which is reserved, under the present policy, for detailed examination; it is here that much tighter restrictions are needed to prevent (and even to rectify) glaring duplication. It is wrong to turn policies upside down in this way.

Para 4-5: Please see margin. The main advantage of 'the freedom' that is complained of lies in the tempo it generates; it is easy to put a 'damper; more difficult to generate momentum.

There seems nothing in writing from Delhi. If policy is to be modified, this should be preceded by some written comments from Delhi, besides oral advice.

18.10.1969

DG (A)

Governor

23

When I was in Delhi, I had the occasion to discuss with Shri Baksi the question of branch licensing policy. The views which he expressed are not quite the same as summarized in para 2 of E.D.(S)'s note of 17.10.69. In fact, his thinking and mine were not dissimilar and I set out below the salient points.

The responsibility for branch licensing must continue to be that of the Reserve Bank as in the past.

While it is obviously desirable that nationalized banks should, among themselves, agree upon a coordinated programme of branch opening, we shall have to look at their proposals to take into account certain factors which may not have been prominent in the minds of the Group considering the allocations among themselves.

We have to take into account the interests of the State Bank on the one hand and the non-nationalized banks on the other.

We have to see that in an attempt to share out the responsibility for opening branches in rural areas, there is not merely an arithmetical allocation under which all banks carry a pro-rata responsibility in all backward areas, but that the pattern is one which will enable banks to concentrate and feel specially responsible for certain areas.

Towards this end, certain things will have to be watched. If, for example, a Bombay bank is to open say a dozen branches in Bihar, it would be preferable to allow these branches to be concentrated in a certain area in Bihar on which they could focus and for which they could provide one or two senior officers for overall supervision rather than scatter the branches all over the State. Factors such as language and distance are, no doubt, relevant in this context but cannot be given too much weight. Thus, to take another example, if the Bank of Canara with its specialized knowledge of helping small-scale industries wanted to go to the rural areas of Kashmir we should welcome it, but in that event it won't do for it to have just one or two branches. When a bank wants to have a very few branches in a particular State, it can better remain in the cities; entry into the rural areas has to be in a somewhat concentrated form.

After D.G. (A) and E.D. (S) have seen this note, I should like to have a word with them.

L.K. Jha

27.10.1969

1. Discussed with D.G. (A) and also with Governor. Governor referred to some of these points at the meeting of the Standing Committee of bankers on the 1st November 1969, and subsequently, Shri Nariman also mentioned to him the need for allocating the burden of responsibility for opening branches in the underbanked states and for the intensive development of particular districts under the lead bank scheme, in such a manner that banks like the Canara and Syndicate Banks and the Bank of Baroda and the Bank of India will be able to accept a fair share of the responsibility—particularly in Uttar Pradesh, Madhya Pradesh and other underbanked states.

2. We may await the final report of the Nariman Committee.

R.K. SESHADRI
15.11.1969

24

I have been looking at the Report of the Nariman Committee. I know its recommendations are under examination. While I shall await the comments that might be offered, there are one or two points on which I am not quite clear about the rationale of the Committee's approach and would welcome any elucidation that Shri Mangesh Nadkarni might offer.

My doubts arise not so much on the principles and recommendations in the Report of the Committee but in regard to the actual allocations recommended. When the people concerned themselves agreed that a certain pattern is fair and equitable among them, my first reaction is to accept what has been recommended. However, my doubts remain and as they pertain to efficient working of the system rather than equity in the matter of apportionment of responsibilities and opportunities, I thought I would set them down.

In the matter of allocation of districts to lead banks, I do, in certain cases, entertain a doubt whether the chosen bank can, in fact, deliver the goods in the districts allocated to it. I notice, for example, that the Dena Bank has one district in Uttar Pradesh, three in Madhya Pradesh and one Union Territory—Dadra and Nagar Haveli. The last makes sense because it is close enough to the areas where the Dena Bank is strong and well placed to serve. I am not sure how effective we can reasonably expect it to be in a solitary district in Uttar Pradesh and further whether in Madhya Pradesh it would not have fared better in Mandsaur and Ratlam which are much nearer to Bombay and have been allotted to the United Commercial Bank rather than in Raipur, Bastar and Durg which are nearer to headquarters of the United Commercial Bank. This is only by way of illustration, but a further scrutiny of the proposed list from this angle may be worthwhile.

The second thing about which I have a doubt is that in the allotment of towns for the branch licensing programme, the choice does not seem to take into account the allocation of districts for lead bank purposes. Would it not make better sense for the lead bank to assume, as an initial part of its responsibility, the opening of branches in the unbanked towns in that district?

As I have said, I would welcome Shri Mangesh Nadkarni's comments on both these points. Further, it might help consideration to have the recommendations translated into a bankwise statement in which, in respect of each bank, would be shown the number of existing or licensed branches in each State together with the number of districts and towns now proposed to be entrusted to it, again on a datewise basis.

21.11.1969

(Notes have been submitted to Governor. Some adjustments have been made in the allocations of districts under the 'draw bank' scheme/allotments of unbanked towns. Circulars have been issued on the 23rd December 1969 to banks.)

25

Syndicate Bank Ltd.
Manipal
Mysore State
India

Camp: P.B. 196
BOMBAY
1 December 1969

Dear Shri Jha,

Standing Committee meeting on 12th December Report of the Committee on Branch Expansion Programme for the Public Sector Banks
On going through the report, I felt like raising a few issues for consideration by the Committee. May I request that the points I have raised are got examined?

Has the lead bank any definite commitment for opening a definite number of branches in the district assigned to it within a specified time? If a commitment of this nature is not there, how do we expect the country to be covered by the required number of branches within a reasonable time?

Will the lead bank enjoy any priority in opening the branches in the district assigned to it?

The manpower planning and training up of personnel required for assuming the role of development is possible only when each bank is prepared to take up the responsibility for a specific area, and not otherwise.

Involvement of a bank in agricultural finance, filling up of the credit gap and mobilization of deposits is possible only by a network of branches in an area.

Geographical accessibility of a branch is a must for this purpose. Unless each bank knows its areas of operation definitely, it will be unable to make any commitment for manpower assessment and training.

It would not be possible for it to build up the necessary infrastructure for developmental activities unless it is willing to establish a fairly large number of branches itself. In view of this, the recommendations in para 6.3 on page 17 will not make for effective functioning of a lead bank.

While I agree that no monopoly need be created, it would be worthwhile for each bank to fulfil its own commitments in the district where it has assumed

leadership and then only think of venturing into other fields. Otherwise, large areas of the country will remain unbanked.

Unless the branches of banks are evenly spread out throughout the country, the pattern of credit distribution will not be uniform, credit being extended in only those areas where there are banks and the areas without a sufficient number of banks being unable to get their requirements of credit. It would thus widen the disparity that exists today. In the light of this, I am not clear what role the other lead bank to which the district of Nellore has been assigned will have to fulfil there, where we had at the instance and with the help of the Reserve Bank had made an exhaustive survey and subsequently applied for a network of branches there. If in future the other lead banks have to get priority for other branches in that district, it would be worthwhile for us to withdraw our applications in respect of Nellore as it would be uneconomical for us to work up this area by building up personnel for agricultural operations. In the absence of a clear-cut idea on branch banking, we fear we might be denied a chance to open branches where we would find it necessary to carry out these operations.

We had surveyed the Mandya district along with the Reserve Bank of India and the survey indicated that there are no places worth opening a branch by a commercial bank in view of the cooperative institutions in existence. I now find that the State Bank of India has been allotted (please see Annexure I Statement VI under Mysore) three branches in the important centres while the Syndicate Bank has been made the lead bank. Obviously, if the State Bank will have a larger number of branches in the area, what role can Syndicate Bank be expected to play in this district?

Before its nationalization, the Syndicate Bank had thought of developing Bellary District intensively and also of covering it up with a large number of branches, after undertaking a survey of the district jointly with the Reserve Bank of India. We have, since then, in fact, opened a number of branches in unbanked centres in this area. Now this district has been allotted to the State Bank as the lead bank. Though we have no objection to this, it is felt that the bank which had surveyed the district ought to have been chosen as the lead bank.

For the reasons mentioned above (please refer Annexure I Statement VI page 9 under Tamil Nadu), the Syndicate Bank will be willing to surrender the five places in Chingleput to the lead bank of the district. We had applied for Laccadive Islands where there is not even a single bank at present. We have been told we would not be granted that as the lead bank in the area is the State Bank, whereas in Krishna district for a village that we had applied for, we have been informed that the State Bank has been issued a license and it may not be worthwhile for us to open a branch there. This has created a lot of confusion in our own mind and a definite policy might save a lot of work for us as well as for the Reserve Bank in the matter of branch licensing.

Annexure I Statement III Puzhathi in Cannanore district is the same as Chirrakal where we have already opened a branch. This place has a population of 5,000 only and now I find it has been allotted to State Bank of Travancore, vide Annexure I Statement III.

Please refer to Annexure I Statement III Naregal in Dharwar district, has been

classified under Maharashtra—it should be in Mysore. This may kindly be corrected.
With regards,

Shri L.K. Jha
Governor
Reserve Bank of India
Bombay

Yours sincerely,
T.A. PAI

c.c. Dr R.K. Hazari
Deputy Governor
Reserve Bank of India
Bombay

c.c. Shri M. Narasimham
Secretary
Reserve Bank of India
Bombay

26

REPORT OF THE NARIMAN COMMITTEE

The note recorded by Governor in connection with the above report is placed below. As desired therein, elucidation is furnished in the following paragraphs in regard to the allocation of districts and the allotment of centres. This note is submitted in advance for explaining the issues generally, pending a detailed examination of the allocation as also the preparation of a bankwise statement which is in progress.

Allocation of the Districts

2. The Nariman Committee appointed a Sub-Committee consisting of the operational heads of all the nationalized banks to go into the question of allocating districts for 'lead bank' purposes as also the allotment of unbanked centres and to make its recommendations to the Committee. The State Bank of India also participated in the deliberations of the Sub-Committee in its second and third meetings. In the light of the discussions held in the second and third meetings, the State Bank of India was given by the Sub-Committee a fair number of districts as well as centres. As regards the allocation of the districts among the other public sector banks, the broad principle adopted was the contiguity of the districts to the main area of operation of each of the banks. Certain exceptions were made having regard to the fact that some of the districts had already been surveyed by one or the other nationalized banks either on its own or in association with the survey teams formed by the Reserve Bank. In these cases, it was generally felt desirable to allocate the district to the bank which had surveyed it. In a few such cases, the concerned bank had already gone ahead with the preliminaries for undertaking intensive

agricultural credit operations with a view to reaching the targets fixed for it.

3. On an analysis of the proposals made by the Sub-Committee regarding the allocation of the districts in the seven underbanked states, viz. Assam, Bihar, Jammu and Kashmir, Madhya Pradesh, Orissa, Uttar Pradesh and West Bengal, it was found that the allocation had become somewhat unbalanced in the sense that some of the banks with their main areas of operation in the eastern and northern India had to take up a disproportionately large number of districts in the above underbanked states by virtue of the contiguity of the districts to their main areas of operation. It may be observed in this connection that with the exception of Madhya Pradesh, the underbanked states are located in the eastern and northern India. Thus, for example, the United Commercial Bank and Allahabad Bank had, as their share in the allocation, as many as twenty-five and eighteen districts respectively, whereas some of the bigger Bombay banks, viz. Central Bank of India, Bank of India and Bank of Baroda had been allotted only nine, ten and six districts in the above states. The consensus among the members of the Committee in its last meeting held on the 12th November 1969 was that the banks in the eastern and northern regions which had a rather large number of districts for 'lead bank' purposes might find it difficult to effectively play their role in respect of so many districts. The Committee, therefore, decided to make adjustments in the allocation of the districts so as to rectify, to the extent possible, the above imbalances. Accordingly, some more districts, particularly from Uttar Pradesh and Madhya Pradesh, were allocated to the above three Bombay banks, although the latter two of these do not have any appreciable network of branches in those states. In allocating the districts thus in comparatively distant areas, the Committee has also held the view that in cases where, on the basis of the resources and manpower, any of the nationalized banks could be expected to deliver the goods, the contiguity of the districts to its main area of operation need not be the sole criterion and the distance need not necessarily stand in the way of the district being allocated to such a bank. Certain subsequent adjustments were accordingly made in the allocation of the districts in the underbanked states on the lines broadly indicated by the Committee in its meeting referred to above. On a closer look at the allocation, it, however, appears necessary to judge the ability of the 'lead bank', especially the smaller ones, to effectively play its 'lead bank' role in regard to some of the districts. A detailed study of these instances has been undertaken and the suggestions for remedial action, if any, will be put up later.

4. As regards the specific instances cited in the note placed below, viz. the allocation of Rae Bareilly district in Uttar Pradesh and Raipur, Bastar and Durg districts in Madhya Pradesh to the Dena Bank, it may be clarified that that bank had already undertaken intensive agricultural credit operations in the Raipur district (notwithstanding its being distantly situated). That bank, therefore, desired that it should be permitted to retain the district for the 'lead bank' role purposes. The Bastar and Durg districts are contiguous to the Raipur district, and hence those two districts were also allotted to it by the Sub-Committee, partly with a view to relieving

excessive burden on the other banks given the 'lead bank' role in Madhya Pradesh. As regards the allotment of the Rae Bareilly district in Uttar Pradesh to the Dena Bank, it may be stated that the Dena Bank requested the Sub-Committee for assigning the district to it in view of the fact that it had already extended financial assistance to a sizeable extent to the priority sectors operating in the district from its existing office at Lalganj. It had also already undertaken a detailed survey of the district on its own and had selected about ten centres for opening its offices there. In view of the above, the Sub-Committee agreed to allot the district to the Dena Bank.

Allotment of Centres

5. In allotting the unallotted centres out of the 580 unbanked centres, the Committee has not been necessarily guided by the allocation of the districts for 'lead bank' role purposes. The first list of 106 centres, each having a population of 10,000 and over, was circulated by the Reserve Bank in April 1969. The second list of 197 centres was also circulated by the Reserve Bank soon thereafter. The banks were then requested to make their selection of these centres and indicate their choice. In regard to the centres covered by these two lists, the banks tried to assess the suitability of each of the centres from their own angle. While some of these centres had already been allotted by the Reserve Bank on the basis of the choice indicated by the banks, the remaining centres were considered for allotment by the Committee. However, in making the allotment of the remaining centres out of the two lists as also the third list of 277 centres, the Committee felt it desirable to request each of the nationalized banks to indicate its choice in the light of its own assessment made after the receipt of the first two lists from the Reserve Bank or subsequently. The allotment has accordingly been made by the Sub-Committee, mainly in accordance with the choice indicated by each of the banks on the basis of the latter's own assessment of suitability to it. The existence of the allottee bank's offices in one or more towns in the vicinity, has also been taken into consideration by the Sub-Committee in making the allotment.

6. As will be seen from the Committee's report (vide paragraph 6.3 on page 17), the Committee has expressed a view against the 'lead bank' scheme giving rise to a monopoly in the matter of branch expansion in favour of the 'lead bank'. With a view to ensuring a fair allotment of centres for opening of bank offices in the district, it has been suggested by the Committee in the above paragraph that the 'lead bank' should follow a process of mutual selection of centres in the district in consultation with the other banks already operating in the area, so that the 'lead bank' does not take for itself only high potential centres in the district leaving the low potential centres to the associate banks. It is in the context of the above approach that the Committee has not linked the allotment of the 580 unbanked centres to the allocation of the districts for 'lead bank' purposes.

Submitted.

Sh. Nadkarni
Addl. C.O.
3.12.1969

C.C.(O)

A further note on the subject with detailed appendices showing the number of towns allotted and the number of districts taken up by each bank under the 'lead bank' scheme is also placed below.

D.G. (H)

Governor

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Ref. DBOD. No. B.D. 4327/C.168-69

December 23, 1969

Pausa 2, 1891 (Saka)

State Bank of India and its Subsidiaries

14 Nationalized Banks

Andhra Bank Ltd.

Bank of Rajasthan Ltd.

Dear Sirs,

Branch Expansion Programme—Allocations of Districts under the
'Lead Bank' Scheme

As you are aware, the Governor of the Reserve Bank of India had appointed a committee under the chairmanship of Shri F.K.F. Nariman to evolve a coordinated programme for ensuring the setting up of adequate banking facilities in the underbanked districts of the country. The committee, in its report submitted to the Reserve Bank on 15 November 1969, has made recommendations for setting up 'lead' banks for each underbanked district, on the lines suggested in the report of the Group presided over by Professor Gadgil, as well as for opening bank branches to fulfil the target which had been adopted earlier of providing every place designated as a town in the last census report with a bank branch by the end of 1970. This letter relates to the lead bank scheme and a separate communication is being sent regarding branch expansion.

2. The recommendations of the Nariman Committee were discussed at a meeting of the Standing Committee of bankers on the 12th December 1969. The principle of the lead bank scheme was endorsed at that meeting. Certain comments were made in regard to the detailed allocation and Chairmen/Custodians were told to communicate their suggestions for change if any which they considered to be desirable in the allotments proposed by the Nariman Committee. Taking into account the comments which have since been received, the Reserve Bank has now made certain adjustments in the allocation of the districts. The following general considerations have also been kept in view by the Reserve Bank in making these adjustments:

- (i) There should be a broad correspondence between allocation of responsibility (in terms of number of districts) and the resource base of banks concerned. The resource base, in turn, should take into account the deposits of the bank and its existing branch network, both in number and location.

- (ii) In allotting 'Lead Bank' districts, the factor of contiguity has been borne in mind. Contiguity has been broadly defined to include clusters of districts. Such clusters would go a long way towards ensuring viability of operations as well as providing control points for developmental work and branch supervision. They would also provide the basis for long-term growth of banks in the districts allotted to them.
- (iii) As far as possible, the existing regional orientation of banks has been kept in mind. In addition, the claims of one or two regional banks, which are not nationalized, have been taken into account.
- (iv) The re-allocation has provided that in each state, barring certain exceptions, there would be at least two or more Lead Banks. Similarly, as far as possible, each bank has been allotted districts in more than one state.
- (v) Metropolitan centres as well as some Union Territories have not been allotted under the Scheme.

3. The Annexure to this letter gives the details of allotments of the various districts under the Lead Bank Scheme. A map setting out the allotment of lead districts will be forwarded to you in due course.

4. With the designation of a particular bank as a Lead Bank in a district, the concerned bank will be responsible for taking the leading role in surveying the credit needs, in the development of branch banking and extension of credit facilities in the respective district. The more specific functions of a Lead Bank in a district may be spelt out in some detail as under:

- (a) Surveying the resources and potential for banking development in its district;
- (b) Surveying the number of industrial and commercial units and other establishments, and farms, which do not have banking accounts or depend mainly on moneylenders, and increasing their owned resources through the creation of surpluses from additional production financed from the banking system;
- (c) Examining the facilities for the marketing of agricultural produce and industrial production, storage and warehousing space, and the linking of credit with marketing in the district;
- (d) Surveying the facilities for the stocking of fertilizers and other agricultural inputs and the repairing and servicing of equipment;
- (e) Recruitment and training of staff, for offering advice to small borrowers and farmers, in the priority sectors, which may be covered by the proposed credit insurance schemes and for the follow-up and inspection of the end-use loans;
- (f) Assisting other primary lending agencies; and
- (g) Maintaining contacts and liaison residually with Government and quasi-Government agencies.

5. The Lead Bank will be expected to assume the major role in the development of banking and credit in the allocated districts. At the same time, there is clearly no intention that the lead bank should have a monopoly of banking business in a district. The bank assigned the lead role is thus expected to act as the consortium leader and after identifying through survey, areas requiring branch expansion and areas suffering from credit gaps, it should invoke the cooperation of other banks

operating in the district for opening branches as well as for meeting credit needs.

6. The Reserve Bank of India will be in close touch with the banks concerned in the operation of the scheme and would appreciate banks bringing to its notice any problems they may be having in this regard. It would be useful if banks were to submit a quarterly progress report on the working of the Lead Bank Scheme for our information and any necessary action. We also trust that banks will exchange information of their experience in the operation of the Lead Bank Scheme with other banks.

7. Please acknowledge receipt.

Yours faithfully,
R.K. HAZARI
DEPUTY GOVERNOR

28

From Narasimham to D.N. Ghosh

Reference your telex of yesterday stop material for reply to Parliament Question is furnished below:

The National Credit Council at its meeting held in Delhi on 24th July 1968 adopted the report of its Standing Committee on the subject of guidelines in respect of credit allocations in 1968–69. The Standing Committee had addressed itself as a matter of immediate urgency to the question of increasing the participation of commercial banks in the financing of agriculture and small-scale industries. In regard to agriculture, the finance from commercial banks is likely to amount to rupees three hundred to four hundred crores by the end of 1968–69. Of this, a very large proportion would be deployed in food procurement and allied operations. At the same time, commercial banks would be expected to continue their finance for plantations and the marketing of produce other than food grains and in addition provide additional credit facilities for input distribution, medium-term credit for capital investment purposes such as tractors, pumpsets, etc. as well as for equipment and other facilities required for fisheries, dairying, poultry farming, etc. Further, commercial banks are expected to increase their subscription to land mortgage banks' debentures as compared with 1967–68 when their subscription amounted to about rupees eighteen crores excluding the subscriptions by the State Bank. Cooperative banks also are expected in the coming year to increase the quantum of their finance substantially by about rupees three hundred crores on the assumption of normal Kharif and Rabi rains in respect of production, marketing and capital investment. Altogether, the area of institutional finance for agriculture is expected to be considerably enlarged in the coming year. The council has also indicated to banks, in the nature K+ of a guideline an expansion of their credit to the small-scale industrial sector by rupees sixty to seventy crores as against an estimated expansion of rupees thirty to thirty-five crores in 1967–68.

As regards credit requirements of medium- and large-scale industries, the council felt that every effort should be made through appropriate credit policies to secure

the highest possible rate of growth of industrial production in accordance with the plan priorities.

The Reserve Bank will follow these recommendations in formulating its own credit policies and will also take appropriate steps to ensure that the credit extended by the banking system is in conformity with these guidelines.

30.7.1968

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No.B.29

MEMORANDUM TO THE CENTRAL BOARD

Commercial Banks' Assistance to Agriculture and Small-Scale Industries: 1968-69

I

1. *Targets set by the National Credit Council*

At the second meeting of the National Credit Council held at New Delhi on 24 July 1968, it was emphasized that the commercial banks should increase their involvement in the financing of the two priority sectors, viz., agriculture and small-scale industries, as a matter of urgency. The Standing Committee of the National Credit Council had estimated that deposits of commercial banks would increase by about Rs 400 crores during 1968-69, out of which, after allowing for statutory liquidity requirements, roughly Rs 290 crores would be available for credit expansion. The Council indicated that during 1968-69, commercial banks should increase their assistance to the agricultural sector to the extent of Rs 35-40 crores for financing the distribution of fertilizers and other inputs and the direct needs of the farmers (short- and medium-term) that is, production loans for purchasing seeds, inputs, implements, machinery, power tillers, tractors, pumpsets, etc. and also loans for fisheries, dairy farming, etc. This would, however, exclude finance provided to plantations and marketing of agricultural produce (including food procurement finance) as well as subscriptions to debentures of the land mortgage banks. The Council also recommended that commercial banks should enhance their credit to small-scale industries by Rs 60-70 crores. These were indicated as the minimum targets to be kept in view by the banks. Thus, banks would be required to divert between 33 and 38 per cent of the free portion of the estimated fresh accretion to deposits for financing the needs of the two priority sectors. In addition, the Council suggested that commercial banks' investment in debentures of land mortgage banks should be at least 25 per cent higher in 1968-69 compared to 1967-68. Commercial banks other than the State Bank put in Rs 18.35 crores in such debentures last year and on the basis of the Council's recommendation are expected to invest about Rs 23 crores this year.* The amounts to be invested by each bank

*The State Bank's subscriptions to the Land Mortgage Bank debentures during 1967-68 were of the order of Rs 3.79 crores, and on this basis the bank should normally subscribe an additional amount of Rs 4.74 crores during 1968-69 in terms of the Council's recommendations.

will similarly be related to its contribution last year. Commercial banks have also agreed that though such debentures would be 'approved securities' for purposes of statutory liquidity requirements, such investments would not be wholly at the expense of other investments in approved securities. They have informally agreed to count only three-fifths of such investment for liquidity cover purposes.

2. Follow-Up Action to implement the National Credit Council's Targets

The Ad-hoc Committee of Bankers which met on the 16th August 1968, discussed the follow-up action to be taken by banks to implement the decisions taken by the National Credit Council at its second meeting. The general consensus among the bankers present at this meeting was in favour of individual meetings between the Reserve Bank and each one of the major commercial banks for this purpose. Accordingly, discussions were held between 23 August 1968 and 25 September 1968 with twenty major banks (which accounted for 86.3 per cent of the deposits of the banking system as of end June 1968). At the meetings, banks' views were sought on the following aspects:

- (a) their expectations about the likely amount of deposits in the coming year, and the amount of additional lending to the two priority sectors, and
- (b) follow-up action taken by banks to increase deposit mobilization and to ensure the dispensation of credit to priority sectors as proposed, with particular reference to any practical difficulties likely to be experienced by them in realizing the targets.

3. Bank's Estimates as indicated by Bankers

Bank-wise details of the targets in respect of deposit growth and lending to the two priority sectors (*viz.* agriculture and small-scale industries) during these discussions are given in tables 1 and 2. It was decided at these meetings that the targets would be for the period July 1968–June 1969 (although the National Credit Council had in mind the period April 1968–March 1969). This was done in view of the fact that at the time the discussions started, about one half of the financial year was already over. A July–June basis was considered, therefore, to be more meaningful from the point of view of action by banks to achieve the targets.

4. Deposits

The expectation of these twenty major banks is that in 1968–69 their deposits will increase by about Rs 414 crores, as against Rs 402 crores in 1967–68 and Rs 335 crores in 1966–67. These twenty banks account for about 86 per cent of the total deposits of the banking system. The growth in deposits of banks other than these twenty banks is estimated to be around Rs 50 crores in 1968–69, or about the same as in 1967–68. On this basis, the estimates of deposit growth for the banking system as a whole would work out to Rs 464 crores as against Rs 452 crores in 1967–68. On a April–March basis, the Standing Committee of National Credit Council had estimated the annual deposit growth at about Rs 400 crores for 1968–69. Since these estimates were made, conditions have turned out to be somewhat more encouraging; the annual order of deposit growth of Rs 464 crores in 1968–69 on a July–June basis may be viewed in this context.

5. *Lending to the Priority Sectors*

The twenty major banks have indicated that their direct credit to agriculture would increase by Rs 44 crores and their lending to small-scale industries by Rs 93 crores in 1968–69 (Table 2). These twenty banks account for about 86 per cent of the total scheduled bank deposits and on this basis, the estimates of additional credit to agriculture and small industries for the banking system as a whole would work out to Rs 51 crores and Rs 108 crores, respectively. But considering the fact that some of the smaller banks are known to two priority sectors, could be somewhat larger than indicated above.

6. These figures imply that banks would deploy about 47 per cent of their available additional deposits (that is, after providing for statutory liquidity ratio) for financing of agriculture and small-scale industries as against the National Credit Council's expectation of 33–38 per cent. As between agriculture and small-scale industries, the former is expected to get a share of 15 per cent and the latter 32 per cent. Banks have indicated that on the basis of their individual past experience about the utilization of credit limits sanctioned, they would endeavour to sanction appropriate credit limits in order to achieve the actual increase in lending indicated by them.

7. *Overall Picture of Sources and Uses*

It may be noted that the targets indicated by the banks are somewhat in excess of the norms laid down by the National Credit Council, in respect of lendings to the two priority sectors. This is so not only in absolute amounts but also relatively to deposits. This raises the question whether these targets would result in starving other sectors of bank finance needed by them. However, although banks have naturally sought to aim at higher targets, it is somewhat doubtful whether the actual utilization of credit would turn out to be as expected. Success in this matter depends on the progress they make with the organizational and other arrangements under consideration. The higher targets aimed at by banks should, therefore, be regarded as what the banks are aiming at in order to ensure that at least the targets set by the

Table: Banking system: Overall budget for 1968–69 (in Rs crores)

	Deposit growth	Available deposits (after providing for 28% liquidity)	Credit to small-scale industries	Credit to agriculture	Subscription to land mortgage banks (over & above liquidity requirement)	Total 3+ 4+ 5+	Resources available for other sectors
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
1. As estimated by the Standing Committee at the time of the Second NCC meeting	400	288	70	40	10	120	168
2. As now estimated on the basis of banks' targets	464	334	108	51	12	171	163

Council will be fulfilled. Bearing this in mind and taking into account the improved prospects for deposit mobilization, the availability of resources to meet the requirements of other sectors should not pose any serious problem, as will be seen in the following table. In any event, the facilities of refinance from the Reserve Bank both for general purposes and in respect of special sectors such as food procurement, exports, etc. would be available to ease seasonal pressures on the position of individual banks.

8. Deposit Growth—Individual Banks

As regards the magnitude of the deposit growth in respect of individual banks, it may be stated that out of the estimated total deposit growth for the share of six other major banks, viz. the Allahabad Bank, the Bank of Boarda, the Bank of India, the Central Bank of India, the Punjab National Bank and the United Commercial Bank, is expected to be between 5 to 10 per cent of the total deposit accretion. These six banks together would account for 41 per cent (or Rs 192 crores) of the total deposit growth. Another six banks (the Bank of Maharashtra, the Canara Bank, the Syndicate Bank, the Union Bank of India, the United Bank of India and the National & Grindlays Bank) would account for between 2 and 4 per cent of the total deposit accretion individually, and their share in the total deposit accretion works out to be 16 per cent (Rs 75 crores). The individual share of the remaining seven banks would be below 2 per cent and the concerned banks are the Andhra Bank, the Dena Bank, the Indian Bank, the Indian Oversees Bank, the Chartered Bank, the First National City Bank and the Mercantile Bank.

9. Total Allocation to the Two Priority Sectors by Individual Banks

The twenty major banks taken together are expected to allocate 15 per cent and 31 per cent of their additional available deposits to agriculture and small-scale industries, respectively. It may be observed from Table 2 that as many as four banks, viz. the State Bank of India, the Bank of India, the Canara Bank and the United Bank of India expect to divert more than 50 per cent of their individual additional available deposits (after providing for statutory liquidity ratio) to financing of agriculture small-scale industries in 1968–69. It is worth noting that the Bank of India expects to channelize as much as 77 per cent of its additional available deposits to finance the two priority sectors. Another five banks, viz. the Bank of Baroda, the Bank of Maharashtra, the Union Bank of India, the United Commercial Bank and the Chartered Bank expect to divert between 40 and 48 per cent of their individual additional available deposits to financing of agriculture and small-scale industries. The banks which are expected to allocate 35 to 38 per cent of their additional available deposits numbered six, and these are the Andhra Bank, the Central Bank, the Indian Bank, the Dena Bank, the Indian Oversees Bank and the Allahabad Bank. The remaining banks numbering five will divert 27 to 29 per cent of their additional available deposits to the two sectors and the banks coming under this category are the Punjab National Bank, the Syndicate Bank, the First National City Bank, the National and Grindlays Bank and the Mercantile Bank. The twenty banks taken together are expected to allocate 46 per cent of their additional available deposits in 1968–69 for financing of agriculture and small-scale industries.

10. *Agriculture—Individual Banks' Position*

Of the estimated increase of Rs 51 crores in agricultural advances for the banking system as a whole, the share of the State Bank of India will be Rs 10 crores or a little under one-fifth of the target for all banks. Five banks, viz. the Allahabad Bank, the Bank of India, the Central Bank, the Canara Bank and the Punjab National Bank have an individual share between five per cent and 10 per cent. Another five banks whose individual share in the total target is between 3 to 4.9 per cent, together would contribute 22 per cent to the target and these banks are the Bank of Baroda, the United Commercial Bank, the Syndicate Bank, the Union Bank of India and the United Bank of India. Of the remaining nine banks, the four foreign banks* (viz. the Chartered Bank, the First National City Bank, the National & Grindlays Bank and the Mercantile Bank) do not expect to contribute anything while the individual share of others would be below 3 per cent.

11. *Small-Scale Industries—Individual Bank's Position*

As regards the share of individual banks in the target of lending to small-scale industries, it may be seen from Table 2 that as much as 33 per cent is accounted for by the State Bank of India. The individual share of all other banks would account for less than 10 per cent of the total target. The individual share of four banks, viz. the Bank of Baroda, the Bank of India, the Central Bank of India and the United Commercial Bank is ranging between 5 and 10 per cent of the target and their total contribution works out to be 26 per cent. Three banks, viz. the Allahabad Bank, the Punjab National Bank and the United Bank of India are expected to meet between 3 and 4.2 per cent of the target individually, and they together would account for 11 per cent of the target. The individual share of other banks which include the Andhra Bank, the Bank of Maharashtra, the Canara Bank, the Dena Bank, the Indian Bank, the Indian Overseas Bank, the Syndicate Bank, the Union Bank of India, the Chartered Bank, the First National City Bank, the National and Grindlays Bank and the Mercantile Bank would be less than 3 per cent of the target.

12. *Subscriptions to Debentures of Land Mortgage Banks*

As regards the targets for subscriptions to debentures of land mortgage banks, all the banks indicated during the discussions that they would subscribe 25 per cent more than what they did in 1967–68. Some of the banks indicated the likely quantum of subscriptions during the discussions. In the case of other banks which did not readily provide a figure, we have estimated the subscription on the basis of the formula agreed. On this basis, the targets for subscription to debentures of land mortgage banks in 1968–69 in respect of twenty banks would amount to Rs 27.48 crores and the estimate for all banks could be placed at Rs 31 crores. The bulk of the contribution is expected to be made by six major banks, viz. the State Bank (Rs 8 crores), the Central Bank (Rs 3.23 crores), the Punjab National Bank (Rs 3 crores), the Bank of India (Rs 2.5 crores), the Bank of Baroda (Rs 2.29 crores) and the

*Some of the foreign banks like the Chartered Bank indicated that they have some proposals to finance fertilizer distribution under consideration.

United Commercial Bank (Rs 1.45 crores) which together would account for 66 per cent of the target.

13. By and large, the consensus among bankers with whom discussions were held was that there should be recessionary conditions in certain pockets of the economy, some of the banks seemed to be pessimistic about realizing their targets, but, on the whole, the general consensus was that without compromising on the banking principles, it should be possible to increase their involvement. The Reserve Bank has indicated that there will be another round of discussions with individual banks to have a mid-term evaluation of the banks' performance.

II

14. *Organizational and Other Measures to Mobilize Deposits and to Enlarge Assistance to Priority Sectors*

Banks' efforts towards deposit mobilization consist of (a) spreading the network of their branches in new and untried areas and (b) formulating new schemes for popularizing the banking habit among the people by offering better services, several facilities, incentives and innovations. For example, several banks have undertaken either on their own or jointly with other banks, special surveys for assessing the banking potentialities of new regions or centres in the rural areas. They have also arranged for extensive propaganda in the rural areas through various means such as distribution of pamphlets, setting out the facilities and help offered by banks, holding of meetings at marketplaces and small towns, etc.

Deposit Mobilization: Some banks have also introduced novel schemes for attracting the attention of the rural populace (for example, the State Bank of India has arranged for photographs to be taken of individual depositors and distributed the same to their families along with the literature on the bank). Special schemes for issuing different types of deposits have also been evolved by several banks. These include, for instance, the In-Plant banking programme introduced by the First National City Bank through which the bank seeks to enlist the cooperation of the employers (company or firm) to get deposits from the employees of these institutions, introduction of schemes for investment deposits or deposit-passports, collection of deposits through coupons and launching of the programme for a house-to-house canvassing for deposits. A scheme for seeking a direct approach to the white-collar workers in cities has also been started by one of the leading foreign banks while several banks have taken action to improve the quality of the bank's services to the customers. Some banks have also formulated plans for extending advances in new areas in order to attract, at a later stage, deposits from these borrowers.

15. *Measures to Enlarge Assistance to Small-Scale Industries*

In order to enable them to increase their lending to the two priority sectors, namely, small-scale industries and agriculture, banks have, in recent months, taken several organizational and other measures. With a view to ensuring that the targets set by the National Credit Council in respect of lending to small-scale industries and agriculture are realized, commercial banks propose not only to strengthen the existing arrangements but also take further measures; generally speaking, banks'

efforts are being generally directed to strengthen both the agriculturists and the small-scale industries. In the course of the discussions with the individual banks, the Reserve Bank also stressed the areas where action could be taken with advantage.

16. *Administrative and Organizational Measures*

In order to help evolve an approach to the problem of financing the priority sectors, formulate policies and programmes, review the work done, and to provide the much-needed sense of urgency to the task of lending to the priority sectors and generally for overseeing the needs of the priority sectors, some of the banks have already set up special sub-committees of their Boards of Directors consisting, among others, of the directors representing the interests of agriculture and small-scale industries. The Reserve Bank has, in fact, advised all banks to constitute such sub-committees of Boards of Directors without delay. The Bank has also advised that adequate use should be made of the directors representing the interests of agriculture and small-scale industries.

17. With a view to giving special attention to the expeditious processing of the applications of small-scale industries and also to generally undertake developmental work relating to small-scale industries, banks have already set up or are in the process of setting up special cells or departments to deal exclusively with the financing of small-scale industries. Qualified personnel are being recruited to speed up technical formalities in the processing of applications. While some banks have engaged the services of consulting engineers, others are considering the constitution of a panel of consultants to help them in the evaluation of technical feasibility of the projects. Some banks indicated that, apart from assisting the department concerned in scrutinizing the applications and making proper assessment of the technical feasibility of the proposals received from small-scale units, the services of their technical personnel would be made available to guide and assist the small-scale units in the technical aspects of the project. Banks will also be strengthening their liaison with the offices of the Development Commissioner for small-scale industries, offices of the Directorates of Industries of different states, the National Small Industries Corporation, the Small Industries Service Institute, etc., for keeping themselves posted with all the necessary information on small industries. Wider discretionary powers to the agents of the local branches in the matter of sanctioning credit limits of small-scale industries are also being given. Some of the banks have constituted small committees consisting of the local agent and two representatives of the area who contact small industrialists in the locality; they also seek information from big industries about their suppliers. Banks have also been giving particular attention to the opening of branches in industrial estate areas and have also engaged field officers for touring the areas, particularly in the Industrial Estates to assess the potentialities of increasing the scope of bank leading to small industries.

18. One of the difficulties mentioned by the banks to them and that this denied them the facilities of techno-economic appraisal of credit prospects. The Reserve Bank has indicated to banks that in consultation with IDBI, it was proposed to set up technical advisory service to provide guidance to banks on technical, marketing and managerial aspects of small industries. The IDBI is to set up in the initial stages

a small nucleus of technical personnel at each of the regional offices of the IFD of the RBI at Bombay, Calcutta, Madras and New Delhi, so that they can assist the banks to provide technical appraisal reports of new projects as well as on other for modernization and expansion of small industries. These technical cells can usefully maintain close liaison with State Directorates of Industries, with Small Industries Service Institute and the regional offices of the National Small Industries Corporation for exchange of technical and other information. The data collected through contacts with these various institutions should prove invaluable in the assessment of projects and should in turn help the banks for taking more active interest in small industries. The technical staff will also be entrusted with other items of work. The regional cells would undertake active follow-up and periodical inspection of industrial concerns which are assisted by the IDBI. They may also undertake, in collaboration with State and Central Government agencies, special studies of small industries which actually face, or are likely to face, difficulties as a result of factors like obsolete technology, overproduction of particular items, and lack of quality control, and offer suggestions.

19. Orientation of Lending Policies Banks

Banks have generally agreed to bring all their new advances under the Credit Guarantee Scheme. In respect of the existing loans also, efforts will be made by them to bring as many as possible within the Credit Guarantee Scheme. The increased availment of the guarantee facilities is expected to result in commercial banks taking larger interest in financing small-scale industries. As a further inducement to the credit institutions to render more assistance to small-scale industries and to provide some relief to them, the fee for guarantee cover under the Credit Guarantee Scheme for small-scale industries has been reduced from one-quarter of 1 per cent per annum to one-tenth of 1 per cent per annum. The concessional rate will, however, be available only to those credit institutions which decide to seek guarantee in respect of all their eligible advances to small industries sanctioned or renewed on or after 1 October 1968. Some of the procedures relating to obtaining guarantee cover, particularly those relating to the filling of forms, have been considerably simplified. Banks have also been advised to give as much assistance as possible to their borrowers in filling in the necessary forms related to their borrowing from the banks.

20. During the discussions, the bankers also stressed that they were now placing greater emphasis on the feasibility of the scheme, capabilities and technical skill of the people behind the project, the marketability of products and the overall efficiency deserving cases, particularly in the case of educated entrepreneurs and qualified technologists, several conventional lending standards relating to security, margin, etc. were considerably relaxed. Many commercial banks usually charge a preferential rate of 8.25 per cent on their advances to small industries.

21. During the discussions, the Reserve Bank stressed in particular that the Head Offices of banks should keep continuous track of credit refusals by branch agents and analyse the experience of such refusals in order to explore ways and means of being of greater assistance to the small-scale industries.

22. *Publicity and Public Relations*

Banks have also been advised to strengthen their publicity and public relations arrangements and many of them have already brought out or are bringing out useful literature in regional languages explaining the facilities available for lending to priority sectors like small-scale industries and agriculture and the various lending procedures that are in operation. Some of the banks have already started conducting at the bank's regional centres' seminars, in which local industrialists are also invited to participate, for educating branch agents in the procedures and practices of providing finance for small industries.

23. *Measures to help Agricultural Sector*

As regards financing of agriculture, which is a relatively new field for the commercial banks, efforts are being made by banks to improve the organizational and other arrangements in order to be of greater assistance to the agricultural sector. There are serious limitations of personnel, but arrangements are being made to recruit staff with practical experience in agriculture. In the training courses offered in the training colleges of banks, courses on farm finances are being introduced. Bank officers are being deputed to agricultural universities for training in farm techniques. Banks have also been developing contacts with agricultural colleges and universities on various problems of agricultural development. During the discussions, the Reserve Bank stressed the need for strengthening the liaison with State Governments for identification of projects and priorities. In particular, it has been stressed that the regional representatives of banks should be in touch with district officials of the State Government concerned with agriculture, and try to get an idea of projects for development and the total financial needs of the projects. Several of the banks have also selected areas for intensive development and have also proposals to undertake surveys to identify promising areas and projects which can be provided with necessary financing. Some of the banks are also sending officers to Agricultural Refinance Corporation to get practical training of appraisal of projects. Some banks have already held seminars and addressed meetings at certain agricultural universities which have been found extremely useful in bringing the bankers in close contact with the farmers and agriculturists. Some of the banks send their staff experienced in agriculture to visit rural areas, coordinate the bank's credit operations with other agencies, make surveys of soil and credit requirements.

III

24. *Difficulties Encountered by Banks*

In the course of the discussions, some of the difficulties encountered by banks in the speedy implementation of the targets for credit for the two priority sectors were mentioned by the representatives of banks. Some of the more commonly felt difficulties were as follows:

- (i) the difficulties in persuading the borrowers to fill in the various forms relating to financial accounts with particulars as required by the Credit Guarantee Organization;
- (ii) the question of banks lending against equitable mortgage and the

arrangements for recording the land claims in respect of loans to farmers. In this connection, the banks wanted to know whether the Government would be in a position to give protection to commercial banks by way of relief from Stamp Duty and an assurance for recovery in cases of default;

- (iii) the reluctance on the part of big industrialists who are customers for goods manufactured by the small-scale industries to have the bills drawn against them by small industrialists for goods sold to them. This prevents the small industrialists to borrow from banks against receivables making them borrow only against stocks of goods. If such bills get accepted by the purchasers (that is, the bigger industries), the banks said, they could lend even to the extent of 100 per cent of the value of stocks;
- (iv) the Reserve Bank generally advises banks not to lend against imported goods which are over six-month old. This affects the small-scale industries adversely since they usually have to keep over one-year-old goods as they can get the import licence only once a year; and
- (v) difficulties arising from staff indiscipline and problems of direct recruitment in the context of growing requirements.

25. In recent months, the Reserve Bank has made several liberalization in the procedure for obtaining guarantee cover for advances to small industries. Thus, in respect of applications for guarantee against advances below Rs 50,000, banks are not required to forward financial statements from their borrowers. Regional offices of the Industrial Finance Department of the Bank which operates the Credit Guarantee Scheme, have been opened to expedite the work relating to guarantees. The other difficulties mentioned by the bankers are being examined.

IV

26. Credit Policy to Assist Lending to Priority Sectors

This section outlines the measures taken in recent months by the Reserve Bank and its affiliated institutions to facilitate a larger flow of commercial bank credit to agriculture and small-scale industries. Thus, in November 1967, the Reserve Bank informed the banks that refinance would be available at Bank Rate (irrespective of their net liquidity ratios) for their advances for the sales and distribution operations in respect of chemical fertilizers and pesticides. In February 1968, the Bank announced that the total increase in bank advances to the three priority sectors, viz. agriculture (defined as sales and distribution operations in respect of chemical fertilizers and pesticides), small-scale industries covered by the Credit Guarantee Organization and exports, over the average of such advances during the base period (that is, July–October 1966 for slack season and November 1966–April 1967 for busy season) is eligible for refinance at a concessional rate of 4.5 per cent, irrespective of the net liquidity of banks. The Bank has also given a relief in the computation of banks' net liquidity ratio system, so long as this ratio is at or above 30 per cent a bank can borrow at Bank Rate, and that any fall in this ratio beyond 30 per cent would attract a penal rate (on the excess borrowings which is stepped up

progressively with fall in the ratio). The relief in the computation of net liquidity ratio was given in the shape of treating the increases in the lending to the three priority sectors, viz. agriculture defined as sales and distribution of chemical fertilizers and pesticides, small-scale industries covered by the Credit Guarantee Organization and exports over the prescribed base period as part of the liquid assets. This measure would enhance the liquidity ratio and thus reduce the cost of borrowing from the Reserve Bank.

27. The Reserve Bank has also announced certain relaxations from the norms prescribed for banks in the conduct of their banking business in favour of bank advances to agricultural sector and small-scale industries. Thus, unsecured advances to finance sales on hire purchase or deferred payment terms, of machinery and equipment for agriculture, dairy farming and fishing are exempted from the norm stipulated for banks' unsecured advances and guarantees in terms of the Bank's letter of 3 May 1967. Advances to small-scale industries covered by the Credit Guarantee Organization and performances guarantees executed on behalf of small-scale industries are also exempted from the above norm. Further, term loans granted for agricultural development, which are either refinanced by the Agricultural Refinance Corporation or not and to small-scale industries covered by the Credit Guarantee Organization are excluded from the total term loans which are generally expected not to exceed 5 per cent of the total deposits. Recently, the Bank decided to extend the refinance facilities under its Bill Market Scheme to bank advances to cooperative banks for the purpose of enabling the latter to make advances to small-scale industries.

28. The IDBI is providing refinance to banks in respect of medium-term loans to small-scale industries covered under the Credit Guarantee Scheme at a concessional rate of 4.5 per cent (as against its normal lending rate of 6 per cent), provided the effective interest rate of the lending institutions is not more than 8 per cent. The minimum amount of loan refinanced and the extent of refinance was also liberalized in April 1968. Thus, the minimum amount of loan to a small-scale unit covered under the Credit Guarantee Scheme for refinance was reduced from Rs 1 lakh to Rs 20,000 and the amount of refinance was raised from 80 per cent to 100 per cent. The IDBI has also extended its refinance facilities to bills covering sales of agricultural machinery and agricultural implements, as an experimental measure up to the end of June 1969.

29. The Agricultural Refinance Corporation normally provides medium- and long-term credit by way of refinance or otherwise for development of agriculture and other allied industries. Recently, the Corporation has relaxed its policy of refinance facilities to banks and mention may be made in this connection about the Corporation's decision to make where the cultivators come under the area of operation of a sugar factory and the factory is prepared to assist the bank in supervision, technical guidance, recovery of loans, etc. The Corporation has also decided to entertain proposals from banks for financing the purchase of power tillers, tractors, pumpsets, etc. and provide refinance for the purpose, provided

Table 1: Deposit accretion during 1968–69 (July–June)

Name of the Bank	Actual level of deposits as at the end of June 1968	Percentage share of the bank in the total deposits	Expected growth of deposits during 1968–69 (July–June)	Deposits available after providing for 28% liquidity requirements during 1968–69 (July–June)	Percentage share of the bank in the expected growth of deposits (Rs 464.4 crores)
	(1)	(2)	(3)	(4)	(5)
1. State Bank of India	838	21.1	110.0	79.3	23.7
2. Central Bank of India	384	9.7	35.0	25.2	7.5
3. Punjab National Bank	321	8.1	45.0	32.4	9.7
4. Bank of India	302	7.6	27.0	19.4	5.8
5. Bank of Baroda	232	5.8	30.0	21.6	6.5
6. United Commercial Bank	164	4.1	25.0	18.0	5.4
7. United Bank of India	121	3.0	11.0	7.9	2.4
8. Canara Bank	118	3.0	15.0	10.8	3.2
9. Dena Bank	104	2.6	8.0	5.8	1.7
10. Allahabad Bank	99	2.5	30.0	21.6	6.4
11. Union Bank of India	107	2.7	12.0	8.6	2.6
12. Syndicate Bank	81	2.0	15.0	10.8	3.2
13. Indian Bank	66	1.7	8.4	6.0	1.8
14. Bank of Maharashtra	65	1.6	10.0	7.2	2.2
15. Indian Overseas Bank	54	1.4	8.0	5.8	1.7
16. Andhra Bank	37	0.9	5.5	4.0	1.2
17. National & Grindlays Bank	192	4.8	12.0	8.6	2.6
18. First National City Bank	59	1.5	5.0	3.6	1.1
19. Chartered Bank	52	1.3	1.5	1.1	0.3
20. Mercantile Bank	29	0.7	1.0	0.7	0.2
Total of 20 banks	3425	86.3	414.4	298.4	89.2
Other Scheduled Commercial Banks	544	13.7	50.0*	36.0	10.8
All Scheduled Commercial Banks	3969	100.0	464.4	334.4	100.0

*Assumed to be the same as the growth of deposits for these banks during 1967–68.

Deposits Growth (Rs Crores)

	Major Banks	Other Banks	Total
1966–67	335	59	394
1967–68	402	50	452
1968–69 (Estimated)	414	50	464

Table 2: Targets for lending to agriculture and small-scale industries July-June 1968-69

Name of the Bank	Actual level of advances as at the end of June 1968	Percentage share of the bank in total advances as of end June 1968	Advances to agriculture (excluding Plan-tations)	Col. (3) as % of Col. (1)	Advances to small-scale industries as of end June 1968	Col. (5) as % of Col. (1)	Deposits available after providing for 28% liquidity requirements during 1968-69	Targets of 1968-69		Total of Col. (8) and Col. (9)	Col. (11) as % of Col. (7)	Col. (12) as % of Col. (7)	Col. (13) as % of Col. (7)	Contribution of the bank to the total targets (Percentages)
								Increase in advances to agriculture	small-scale industries					
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)
1. State Bank of India	776	25.0	3.39*	0.6*	63.00	8.1	79.3	10.00	35.00	45.00	12.6	44.2	56.8	19.6
2. Central Bank of India	302	9.7	0.12*	..*	20.57	6.8	25.2	3.00	6.10	9.10	11.9	24.2	36.1	5.9
3. Punjab National Bank	224	7.2	12.87	5.7	10.19*	5.3*	32.4	5.00	4.50	9.50	15.4	13.9	29.3	9.8
4. Bank of India	213	6.9	0.04*	..*	6.00	2.8	19.4	5.00	10.00	15.00	25.8	51.5	77.3	9.8
5. Bank of Baroda	166	5.3	1.58	1.0	6.66	4.0	21.6	2.50	6.34	8.84	11.6	29.4	41.0	4.9
6. United Commercial Bank	127	4.1	0.28	0.2	7.64*	6.2*	18.0	2.50	6.00	8.50	13.9	33.3	47.2	4.9
7. United Bank of India	91	2.9	0.14*	0.2	4.52*	5.2*	7.9	2.00@@	3.22	5.22	25.3	40.8	66.1	3.9
8. Canara Bank	85	2.7	0.88	1.0	10.04*	13.6*	10.8	3.00	3.00	6.00	27.8	27.8	55.6	5.9
9. Dena Bank	69	2.2	0.95	1.4	7.81	11.3	5.8	1.08	1.15@	2.23	18.6	19.8	38.4	2.1
10. Allahabad Bank	66	2.1	-*	-*	3.24*	4.8*	21.6	3.00	4.50	7.50	13.9	20.8	34.7	5.9
11. Union Bank of India	70	2.3	3.83	5.5	2.55	3.6	8.6	2.00	1.50	3.50	23.3	17.4	40.7	3.9
12. Syndicate Bank	59	1.9	1.65	2.8	6.99	11.8	10.8	2.00	1.00	3.00	18.5	9.3	27.8	3.9
13. Indian Bank	54	1.7	0.70	1.3	8.32	15.4	6.0	0.85	1.30	2.15	14.2	21.7	35.9	1.7
14. Bank of Maharashtra	44	1.4	1.43	3.3	6.34*	16.1*	7.2	0.95	2.50	3.45	13.2	34.7	47.9	1.9
15. Indian Overseas Bank	39	1.3	0.13*	0.4*	7.29*	20.4*	5.8	0.58	1.50	2.08	10.0	25.9	35.9	1.1

16. Andhra Bank	27	0.9	1.39	5.1	2.40	8.9	4.0	0.50	1.00	1.50	12.5	25.0	37.5	1.0	0.9
17. National & Grindlays Bank	163	5.3	-*	-*	3.49	2.1	8.6	-	2.50	2.50	-	29.1	29.1	-	2.3
18. First National City Bank	38	1.2	-	-	0.83	2.2	3.6	-	1.00	1.00	-	27.8	27.8	-	0.9
19. Chartered Bank	42	1.4	-	-	1.78	4.2	1.1	-	0.50	0.50	-	45.5	45.5	-	0.5
20. Mercantile Bank	28	0.9	-	-	1.67	6.0	0.7	-	0.20	0.20	-	28.6	28.6	-	0.2
Total of 20 banks	2683	86.5	29.38	1.1	181.33	6.8	298.4	43.96	92.81	136.77	14.7	31.1	45.8	86.3	86.3
Other Scheduled															
Commercial Banks	420	13.5	4.66++	1.1	28.79	6.9	36.0+	7.04++	14.73++	21.77++	19.6	40.9	60.5	13.7	13.7
All Scheduled															
Commercial Banks	3103	100.0	34.04	1.1	210.12	6.8	334.4	51.00	107.54	158.54	15.2	32.2	47.4	100.0	100.0

Note: @ Rs 2 crores suggested by us.

@@ Rs 95 lakhs suggested by the bank.

* Relate to 31 March 1967—Purpose-wise survey of Bank Advances.

+ Estimated on the basis of Rs 50 crores deposit growth for these banks.

++ Estimated on the basis of the share of the banks to total deposits as of end June 1968.

.. Negligible.

Table 3: Budget for additional deposits during 1968-69 (July-June)

Name of the Bank	Growth of deposits during 1968-69 (July-June)	Deposits available after providing for 28% liquidity requirements	Lending to priority sectors for 1968-69 (Agriculture)	Small-scale industries	Exports [@] 40% of the additional (targetted)	Subscription to debentures of L.M.B.	Total of Col. (3)+ Col. (4)+ Col. (5)+ Col. (6)	Balance available for meeting other requirements Col. (2)-Col. (7)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
1. State Bank of India	110.00	79.30	10.00	35.00	4.10	3.20	52.30	27.00
2. Central Bank of India	35.00	25.20	3.00	6.10	1.40	1.29	11.79	13.41
3. Punjab National Bank	45.00	32.40	5.00	4.50	0.40	1.20	11.10	21.30
4. Bank of India	27.00	19.40	5.00	10.00	1.30	1.00	17.30	2.10
5. Bank of Baroda	30.00	21.60	2.50	6.34	1.20	0.92	10.96	10.64
6. United Commercial Bank	25.00	18.00	2.50	6.00	1.20	0.58	10.28	7.72
7. United Bank of India	11.00	7.90	2.00**	3.22	0.20	0.16	5.58	2.32
8. Canara Bank	15.00	10.80	3.00	3.00	0.90	0.40	7.30	3.50
9. Dena Bank	8.00	5.80	1.08	1.15*	0.20	0.39	2.82	2.98
10. Allahabad Bank	30.00	21.60	3.00	4.50	0.40	0.41	8.31	13.29
11. Union Bank of India	12.00	8.60	2.00	1.50	2.30	0.31	6.11	2.49
12. Syndicate Bank	15.00	10.80	2.00	1.00	0.40	0.24	3.64	7.16
13. Indian Bank	8.40	6.00	0.85	1.30	1.10	0.12	3.37	2.63
14. Bank of Maharashtra	10.00	7.20	0.95	2.50	0.20	0.22	3.87	3.33
15. Indian Overseas Bank	8.00	5.80	0.58	1.50	1.70	0.18	3.96	1.84
16. Andhra Bank	5.50	4.00	0.50	1.00	0.20	0.06	1.76	2.24
17. National & Grindlays Bank	12.00	8.60	-	2.50	1.20	0.20	3.90	4.70
18. First National City Bank	5.00	3.60	-	1.00	0.10	-	1.10	2.50

19. Chartered Bank	1.50	1.10	—	0.50	0.20	0.10	0.80	0.30
20. Mercantile Bank	1.00	0.70	—	0.20	0.10	0.02	0.32	0.38
Total of 20 banks	414.40	298.40	43.96	92.81	18.80	11.00	166.57	131.83
Other Scheduled Commercial Banks	50.00	(100.0)	(14.7)	(31.1)	(6.3)	(3.7)	(35.8)	(44.2)
		36.00	7.04	14.73	4.90	1.40	28.07	7.93
		(100.0)	(19.6)	(40.9)	(13.6)	(3.9)	(78.0)	(22.0)
All Scheduled Commercial Banks	464.40	334.40	51.00	107.54	23.70	12.40	194.64	139.76
		(100.0)	(15.3)	(32.1)	(7.1)	(3.7)	(58.2)	(41.8)

NOTE: Rs 2 crores suggested by us.

** Rs 95 lakhs suggested by the bank.

* Estimated on the basis of percentage share of advances to export sector (as reported under section 42) to total deposits as of end May 1968. Figures in brackets refer to percentages to total available deposits in the respective bank group.

that the schemes are drawn up keeping in view the area development aspect.

Reserve Bank of India
Economic Department
Central Office
Bombay

B.N. ADARKAR
DEPUTY GOVERNOR
Dated October 21, 1968
Asvina 29, 1890 (Saka)

30

Internal Note

April 1969

There are a few points on which some active thinking is necessary since we shall have to take a final view on them fairly soon.

One question relates to the policy for the slack season. D.G. (An) has been expressing some concern over price trends and suggesting the introduction of some measures of restraints on expansion of bank credit. The extent to which and the manner in which this could be done requires discussion and consideration.

Another issue is the determination of priority sectors and targets, if any, for them for the period July 1969 to June 1970. Since the National Credit Council has left it to us to take the initiative and to have a discussion in the Standing Committee, it will take us quite a few weeks to reach finality and to advise the banks, and therefore, we ought to give some thought to this question also.

It seems to me that merely to step up the targets for small-scale industries and agriculture will not be the right answer, for one thing we ought to evaluate is whether after the sizable increase of bank credit to small-scale industries, there would still be large scale additional needs for working capital in this area. The position regarding agriculture would be different because this is a much vaster field. However, we have brought into the field of agricultural credit quite a variety of operations, some extremely easy such as lending to a Government or a Government's sponsored body against stocks of food and fertilizers. Unless, therefore, we attempt some kind of sub-quotas, the really difficult areas of lending may remain neglected.

However, do these two areas really exhaust the possibilities? There is, of course, the export sector, but there is not target in this case. Can anything else be done to ensure that banks are on the lookout for export business rather than merely deal with such requests as come to them? As the return to banks is not high when they finance exports, the danger of their not being overactive is there.

Another thought comes to my mind. One of the things which has been causing concern is regional imbalance, and this manifests itself quite prominently in operations of banks. Not only are many States underbanked but there is evidence to show that the banking system sometimes transfers resources from poorer areas to richer areas. Is it possible for us to think of any ways in which this imbalance can be corrected? Can we have any objective, non-political criterion, on the strength of which we can ask banks to increase their lending in particular States, and possibly set targets for it? Of course, in any such targets due credit will have to be given for their contribution to State loans, etc. In this context we have also to consider whether

the area approach can be woven into the scheme. For example, in getting an underbanked State better banked, should we discuss and settle with banks the names of those which will take particular responsibility for individual States?

In formulating our ideas on all these subjects, we shall have to bear in mind D.G. (An)'s point about the need for some monetary restraints.

I hope that after we return from Bangalore, there will be some concrete ideas at least to discuss among us.

D.G.(A)

L.K. JHA

D.G.(An)

29.4.1969

Secretary

31

NOTE ON NCC

BOMBAY

D.O. No.

July 18, 1968

Dear Prof. Gadgil,

In the light of our correspondence and discussions, I am circulating a paper to the National Credit Council drawing attention to the points you had made in your written statement which was circulated to the Council at its opening session, as well as in your letter to me.

The paper which we have circulated does not put forward any solution and confines itself to a somewhat colourless account of the present position and past developments. I hope that at the Council meeting you will yourself take a lead in suggesting what the answer to the problem would be.

I confess that I myself see no satisfactory answer even though I fully understand the problem you have posed. The difficulty, I think, lies in the following factors:

- (a) Even though the small man may not easily be able to borrow from a big bank, when it comes to depositing his money he prefers the big bank to a small bank;
- (b) Without adequate deposit resources, smaller banks may be willing, but are unable to help the small man;
- (c) All too often the board of management of small banks lends itself to local influences and pressures in its lending operations so that in course of time it causes to be as sound and viable as one would like it to be.

In other words, smaller banks seem to suffer from all the weaknesses of cooperative banks in certain States.

How can this situation be remedied? One is tempted to suggest that perhaps this is a problem more for the Banking Commission than for the Credit Council because it relates to the structure and organization of the banking industry. Whatever the view about the agency to explore the problem, one still has to think in terms of possible solutions.

One way is to get the larger banks themselves involved in financing small business. This is, in fact, what in a sense the National Credit Council is trying to do. There

are obvious difficulties in doing so. Can greater decentralization of authority and delegation of powers from the central offices to the field officers help to make things a bit easier?

An alternative which one banker has been canvassing is that large all-India banks should have small subsidiaries which will be more localized and also oriented towards meeting the needs of smaller people. Incidentally, and this I believe is his main consideration, such a body would not have to observe the same standards regarding wages and employment which all-India banks have to do because it would be a separate and small entity.

One of the ways in which smaller banks can mobilize more despite it, is by offering a somewhat higher interest. One consequence of this, of course, would be that their lending rates would be higher. Speaking for myself, I have always felt that one should be laying greater emphasis in the adequacy of the credit available than on cheapening the cost of it, but this is not an widely accepted view. Indeed, in an industrial estate in Hyderabad, a point was made that because they have to borrow from the State Bank of Hyderabad and not from the State Bank of India, the interest rates are somewhat higher.

None of what I have said is new to you, but I thought if I indulged in a certain amount of loud thinking, it would enable you to deal with this question when it comes before the National Credit Council.

Yours sincerely,
L.K. JHA

Prof. D.R. Gadgil
Vice Chairman
National Credit Council
New Delhi

No. of date

Copy to Dr I.G. Patel, Special Secretary, Department of Economic Affairs, Ministry of Finance, Government of India, New Delhi.

L.K. JHA
GOVERNOR

32

D.R. GADGIL'S NOTE FOR THE NATIONAL CREDIT COUNCIL

It is expected that the National Credit Council will play an important part in meeting the objectives which Government had in mind when it accepted social control of the banking system. The existing regulatory provisions in relation to banking are used by the Reserve Bank of India for certain limited aims such as security of deposits and regulation of the total volume of credit and direction of its flow. Broader social aims could not be easily fitted in this scheme of regulation and the ordinary devices available to the Reserve Bank may not necessarily serve the purpose of these broader aims. It is necessary, in the first instance, to define the broader aims that a banking

system can serve and the structural reorganization and the attitudes and policies needed to fulfil the aims. It is highly desirable that discussions at the highest level precede action in this regard and that for the larger part action follows through voluntary acceptance of the articulated objectives and not through a set of externally imposed regulatory measures. The National Credit Council ought to be visualized as essentially serving these ends. It follows that the first task before the Council is to evolve a set of directions in which the banking system should move so that social purposes are fulfilled through its operation.

The purpose of this note is maldistributed to highlight a few aspects of this problem. It is hallmark of an unequal society that not only is the ownership of the resources of production very badly distributed within it, but also that operational and other facilities are equally maldistributed. In case of the banking and credit system, as it operated twenty years ago, this inequality was glaringly evident. Those commanding the largest resources not only could get their credit requirements satisfied in the fullest measure but also obtained credit at specially favourable rates. At the other extreme, large masses of small business and households had no access to any institutional credit facilities. Developments during the past twenty years have, in part, changed the picture. The successful carrying out by the State Bank of India of its programme of branch expansion, bringing together the State Bank and the older Indian State Banks into one structure covering the whole country, and a number of experiments undertaken by the State Bank of India in financing small industry and cooperative organizations have contributed towards this. Developments in the cooperative credit structure have made fuller and more widespread institutional credit available to much greater numbers than before and special schemes in finance of small industry have slightly improved the position of categories of artisans and small industrialists. Even so, the basic inequality is still large and the main objective of social control of banking and credit would appear to be that of more evenly spreading available credit over different areas and categories, relatively lowering the cost of credit to small operators.

It is necessary in framing a programme for meeting social objectives through the credit system to take an integrated view of commercial and cooperative banking. Cooperative banking is now under regulation of the Reserve Bank of India. It covers a progressively wider field and because of its organizational structure and approach is specially fitted to deal with problems of the smaller men and the weaker sections. It is not generally realized that in terms of numbers served, the cooperative credit system is today the largest system of institutional credit. The following extracts from a statement made by me some years ago brings this out statistically. The data of today will be even more striking than the data cited in the quotation.

‘As on 30th June 1963, there were 211 thousand primary agricultural credit societies in India with a membership of 217 lakhs. Of the total membership, more than 104 lakh members made borrowings from their societies during the previous year and the average loans advanced per borrowing member was Rs 246. The non-agricultural societies consist chiefly of employees credit societies and urban banks. These together cater to the credit requirements of small traders, government servants

and other wage and salary earners and other similar categories of urban and semi-urban residents. The number of non-agricultural credit societies on 30th June 1963 was 12,850 and their membership was 55 lakhs. They had deposits of over Rs 115 crores and the loans advanced by these societies to members during 1962–63 amounted to Rs 166 crores.’

‘The cooperative credit system is the only well-nigh universal institutional credit system in rural India. It caters through a larger number of organizations to larger numbers of people than any other institutional system, even in urban India. This dispersed and wide coverage of the cooperative credit system is reflected in the locational distribution of the offices of cooperative banks. In 1963, commercial banks in India had 5,495 offices located at 1,860 places; the corresponding figures for cooperative banks were 2,360 offices at 1,864 places. The number of places served by cooperative banks was larger even though their number of offices was almost half than that of commercial banks. The feature is emphasized by the distribution of offices of the two classes among places with differing population. The all-India figures do not bring out the contrast fully as cooperative banking has not developed equally in all states. The figures for Maharashtra in which both commercial banking and cooperative banking may be taken to be well-developed are more instructive. In 1963, commercial banks had 691 offices at 169 places in Maharashtra and the cooperative banks had 673 offices at 483 places; and while the commercial banks had offices at 115 places with a population of less than 25,000, the corresponding number of places with cooperative banks was 385.’

There are two or three aspects of this problem of spreading widely institutional facilities and keeping low the cost of credit to small man. It has to be realized that appropriate instruments must be fashioned before given purposes can be fulfilled. For example, it is the experience in every branch of economic activity that meeting the needs of small man is essentially a dispersed, highly local and small-scale operation which can best be carried out by local institutions which operate on the basis of personal knowledge of local circumstances. It is obvious that some types of large institutions cannot satisfy this requirement easily. In the same way, supplying credit for agricultural production is not only a dispersed and small unit activity but is subject to many risks which are to be fully incorporated in the organization and methods of the credit system. Encouraging and mobilizing savings of small and dispersed establishments is a function which can be performed only by the institutions which distribute credit appropriately. One of the first problems to be studied by the National Credit Council would be the appropriate division of labour among existing categories of credit institutions and the need, if any, for creating special types of institutions for fulfilling certain needs.

Development of commercial banking, for example, in India, has almost entirely gone on lines of the British system. Growth of smaller single unit local banks or district banks with branches concentrated in small areas of operation has not been encouraged. It is for consideration whether in certain areas and for certain aspects smaller units even in the commercial banking field may not be allowed to be established and to grow. The cooperative credit structure being essentially federal

has considerable elasticity and is specially meant at the primary level to fulfil the needs of small men. Primary urban cooperative banking, where it has developed, has given credit facilities to small business in a manner that could never have been otherwise available to them and the salary earners' societies have in a very large measure financed the consumption requirements of very large numbers of salary earners of specific categories very satisfactorily.

It is true that development of cooperative activity has been very uneven and that this is specially so with urban primary cooperative banks. However, I consider it part of the task of the National Credit Council to look into causes of uneven developments of this type and to encourage by special measures the spread in all areas of institutions appropriate for meeting specific ends. There is another aspect of this problem with which Reserve Bank is intimately connected. Furnishing adequate credit to the small man is somewhat difficult in ordinary commercial banking practice because of the lack of security offered and the uncertainty that surrounds the business. The costs of each unit of business also tend to be high. The cooperative approach gets over this, in part, because it brings together groups of persons largely known to each other and, therefore, can operate on the security of knowledge of character and other non-bankable features. However, whether in cooperative banking or in commercial banking where a small local unit adopts practices and procedures appropriate to the situation, it is apt to run up against norms laid down by Reserve Bank or other inspecting authority. The security for credit offered, the margins insisted upon, the number of instalments, the method or frequency of granting extensions and other features of any supervisory system would have to be specially adapted to the needs of financing the smaller men and the weaker sections. The local bank or the cooperative bank can keep down the cost of credit to the small man only because the overheads are smaller or because there is some voluntary work and lower pay scales. Expectations of the regulating authority would have taken account of all such features of the business.

While the cooperative institutions or single unit or small area banks can fulfil certain purposes of social control more effectively than other members of the system, the resources they could command for the purpose may not be adequate. Therefore, the units with command of larger resources could be looked upon as, in part, supplying resources to this other part of the system. The recent practice of commercial banks of buying debentures of Land Development Banks is a step in this direction. It should, therefore, be clear that it is not necessary for each unit in the banking system to try to perform all functions. It should, in fact, be accepted that it is not possible for this to happen and, that to make it happen artificially may involve unnecessary costs.

The newly established National Credit Council will have to review initially the present operations of the various constituents of the credit and banking systems taking an integrated view of the commercial and cooperative systems. Such a review should indicate the reorganizations and the new developments in structures, policies and procedures needed to make the credit system serve objectives of social control and the appropriate part to be played in the future by each category and type. In this manner, the Council could play the part of a nuclear organization where forward

looking thinking is continuously done, from which operations of Government, the Reserve Bank and the Planning Commission could all profit.

D.R. GADGIL

33

Syndicate Bank Limited
T.A. Pai
Managing Director & Chairman

MANIPAL
MYSORE STATE (INDIA)
Camp: P.B. 196
BOMBAY-1
19th May, 1969

My dear Shri Adarkar,

Further to my personal discussion with you, I will submit a separate application for availing of credit from the Reserve Bank of India, under the Bill Market Scheme. But at the same time I would like to suggest that we be permitted also to offer inland usance bills up to 90 days for rediscount.

Banks have been financing manufactures' and wholesalers' accounts receivables and the most convenient way of doing it has been found to be to draw a bill against acceptance to be discounted by the Bank. Creation of such bills is bound to help monetary management and impart flexibility to credit mechanism if they are made eligible for rediscount by the Reserve Bank of India. The Reserve Bank of India Section 17 2(b) has a provision for accommodation against such bills. It is only a question of invoking that provision to enable a bill market to come into existence.

For many years, we have been discussing about the creation of bill market in this country. Unless creation of bills is actively encouraged by the Central Banking Authority by more positive steps like free discounting facility being made available when the banks want to borrow from the Reserve Bank of India, it may as well take many more years to take a shape. The present bill market scheme of the Reserve Bank of India does not take into account the genuine trade bills.

When norms were laid down recently for clean credit and bills drawn for genuine trade transactions covering the needs, by the manufactures on their wholesalers or the wholesalers on the retailers, we have, in fact, given an opportunity for the creation of such bills and banks have started actively encouraging this business. In order to properly canalize credit with the manufactures, wholesalers and retailers, if the Reserve Bank makes it possible for the banks to lodge these bills with them for temporary borrowings, it would go a long way in giving further fillip to this practice becoming popular. When these bills satisfy the conditions laid down under the Reserve Bank of India Act 17(2) (b), as eligible paper since they bear the signature of a bank, the creditworthiness of the manufacturer or wholesaler can be easily ascertained and there should be no problem to handle the bills under the scheme.

Since IDBI bills already provide that the banks should retire those bills three days in advance of maturity, similar practice could be introduced in respect of these bill also. The Banks can arrange their portfolio of bills maturing date-wise in bunches,

the smallest bill covering Rs 5,000, and these will be short-term advances of self-liquidating nature. The bills could be lodged with the RBI with the pronote and a stipulation that they should be retired by the bank three days before the date of maturity. May I suggest that the Reserve Bank introduce this scheme forthwith on the very merits of the scheme, without waiting for the recommendations of the Banking Commission, as it is likely to take some time, so that when the recommendations of the Commission come up, they might be of a more comprehensive nature to cover up other transactions also?

I hope you will kindly consider my suggestions to enable us to offer these bills in the manner that I have suggested or in any alternative manner that you might suggest.

With kindest regards,

Yours sincerely,
T.A. PAI

Shri B.N. Adarkar
Deputy Governor
Reserve Bank of India
Bombay

34

Internal Note

REDISCOUNTING TRADE BILLS BY THE RESERVE BANK OF INDIA

Shri T.A. Pai of the Syndicate Bank Ltd. in his letter dated the 19th May 1969 to the Deputy Governor has stated that under the existing Bill Market Scheme, the Reserve Bank of India makes advances to banks against the security of manufactured or specially created bills, and that the Reserve Bank should now allow banks to offer inland bills with usance up to 90 days for rediscount. In this connection, Shri Pai has stated that banks have been financing manufactures' and wholesalers' accounts receivable and that the most convenient way of doing it has been found to be to draw a bill against acceptance to be discounted by the bank. According to him, creation of such bills is bound to help monetary management and impart flexibility to credit mechanism if they are made eligible for rediscount by the Reserve Bank. He has further stated that as one of the signatures on such bills will be that of a bank and goodness of the second signature of the manufacturer or wholesaler can be verified, these bills will satisfy the conditions laid down in section 17(2) (a) of the Reserve Bank of India Act, and that such bills can be retired by the banks availing of refinance from the Reserve Bank three days in advance of the date of their maturity as is done in the case of bills rediscounted by the Industrial Development Bank of India.

2. The question of substituting the 'manufactured' or specially 'created' bills which are now being lodged with the Reserve Bank as security for advances under the Bill Market Scheme by genuine trade bills was examined in detail in March 1964 at the instance of the then Governor. In this connection, the note dated the 20th March 1964 recorded by Shri Gulmohamed may please be seen. Paragraph 7 of the note gives a summary of the suggestions. To recapitulate, it was stated that

the arrangement of obtaining from the eligible banks 'manufactured' or specially 'created' bills as security for advances under the Bill Market Scheme had been working well and meeting the twin objects of relieving monetary stringency during the busy season, and at the same time enabling the Reserve Bank to exercise a qualitative control on the expansion of credit by commercial banks. It was, however, suggested that a beginning could be made by the banks undertaking acceptance business and creating bank bills so as to promote the development of a market in genuine trade bills. Such bills could be made eligible for rediscount with the Reserve Bank. It was felt that if the Reserve Bank were to offer rediscounting or refinance facilities in respect of trade bills, this might encourage banks to undertake acceptance business which, in turn, could form the basis for the creation of a supply of prime bank bills. However, the offer of rediscounting facilities in respect of such bills by the Reserve Bank would not, by itself, result in an open market for bills. For the development of an open market in bills, the establishment of an institution which would act as a dealer in bills and an intermediary between the banks appeared necessary. The advantage would be that the day-to-day surplus resources of the banks which they lent to each other through brokers on a clean basis could be employed in granting call loans to a discounting institution against the security of parcels of bills, thereby linking the call loan market to bills representing specific trade transactions. This might also enable the Reserve Bank to exercise greater influence in the call money market through its rediscount policy.

3. Shri Joshi, the then Executive Director was of the view that there was scope for development of bill business, especially with the establishment in increasing numbers of industrial and manufacturing concerns which had to give credit facilities to consumers of their goods. However, the various possibilities of developing the use of bills could not be exploited unless acceptance and discount houses were established. The question of offering rediscount facilities by the Reserve Bank would become material only when such bills were on offer. He had, therefore, suggested that it would be advisable if the representatives of the Indian Banks' Association and some prominent bankers interested in this field were called by the Governor for a preliminary talk so that a proper fillip could be given to the establishment of Acceptance and Discount houses, and the part the banks proposed to claim in this regard, considered.

4. Shri Narasimham (then Director of Banking), also touched on this question in his note dated the 21st May 1964. He was of the view that as the creation of the trade bill as a credit instrument would call for a change in commercial banking procedure, the initiative, in a sense, would have to come from the constituents of the banks. His conclusion, however, was that the existing Bill Market Scheme might be continued till the volume of genuine trade or institutional bills increased sufficiently. Shri Pendharkar was of the opinion that from the point of view of central banking control, it did not appear to be absolutely essential that there should be a genuine Bill Market. The control of short-term fluctuations in the supply of credit by the central bank could be effected in several ways. The use of a bill was only one of those methods. Further, in our conditions, the trade bill was not likely to assume significance, as a method of financing the borrower. As far as the part

played by a bill in facilitating inter-institutional finance is concerned, the inter-bank call money market performed this function. Whether its place could be taken by the bills or by bank acceptance, was doubtful. In any case, the bill in its traditional form or as a bank acceptance was not absolutely essential for central banking control. Dr Madan was also of the view that there were real difficulties in resuscitating the genuine Bill Market. The question was discussed by the Governor with the officers concerned but no particular decision was taken.

5. The question whether the Reserve Bank should provide rediscount facilities against trade bills is to be considered from two angles:

- (i) whether the proposal would enable the Reserve Bank to have a better control over credit made available to the banking system; and
- (ii) whether rediscounting of trade bills will be a better method of providing refinance to the scheduled commercial banks as against the present Bill Market Scheme.

From the point of view of Central Bank control, as pointed out by Shri Pendharkar in his note, it is not absolutely necessary that the Reserve Bank should rediscount trade bills. The control is adequately exercised even under the present system.

As regards (ii) above, the existing Bill Market Scheme has been working satisfactorily. While enabling the scheduled commercial banks to obtain the requisite refinance from the Reserve Bank, it enables the Bank to have qualitative control over the relative transaction. Under the Scheme, the Reserve Bank has an opportunity to assess the financial position of the parties whose bills are to be lodged with it and also to ensure that the bills have arisen out of bona fide trade/commercial transactions. These advantages will not be available if bills are to be rediscounted as we will not have an opportunity to ascertain whether the bills have arisen out of genuine trade and commercial transactions, and to assess the financial position of each of the numerous parties whose bills may be offered. Further, many of these bills may be for small amounts. At present, banks obtain refinance under the Bill Market Scheme by converting a few larger advances into bills. This keeps the administrative cost of refinance down both for the borrowing banks and the Reserve Bank. Once we start rediscounting trade bills, we may be confronted with a larger number of small bills. Even if we place a restriction as to the minimum amount for which we will rediscount a bill, at say, Rs 50,000, the administrative work involved in scrutiny of the bills, keeping a track of the due dates, etc. will involve as there is paucity of genuine trade bills which may be eligible for rediscount by the Reserve Bank, it will be necessary to continue the Bill Market Scheme even if we decide to introduce a Scheme of rediscounting trade bills. It is doubtful whether banks will offer trade bills to any appreciable extent when it is so much easier to obtain refinance under the Bill Market Scheme.

6. It may be added that we have in a separate note suggested that the Reserve Bank of India Act may be amended so as to enable the Reserve Bank to provide refinance against declarations of advances (which may also include discounted trade bills) of banks for trade and commercial purposes and to give the Reserve Bank a

first charge on the relative advances which are declared in the proposed declarations. If this is approved and the Reserve Bank of India Act is accordingly amended, the procedure for obtaining refinance from the Reserve Bank will be still more simplified and there would not be any need to have a separate Scheme for rediscounting of bills by the Reserve Bank.

7. In view of the foregoing, there is no need, at present, to provide facilities for rediscounting of trade bills. We may, however, discuss the question with a few bankers, if considered necessary.

24.07.1969

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No. 208–SDB/71

Secretary

MINISTRY OF FINANCE
DEPARTMENT OF BANKING
NEW DELHI
June 19, 1971

My dear Jagannathan,

Yesterday in Lok Sabha, there was a question about the LIC's and the UTI's entry into the call money market. The texts of the question and the answer are enclosed. As you are aware, some of the banks have strong feelings on the subject and now it seems Parliament is becoming curious. Today, FM was recalling a brief discussion some time ago in his room with you on this matter. You appeared of the view that some ceiling on interest rates payable by the banks to the LIC and the UTI in the call money market could perhaps be imposed. It would be nice if you could give the matter your further consideration and indicate what the Reserve Bank proposes to do.

With kind regards,

Yours sincerely,
A. BAKSI

Shri S. Jagannathan
Governor
Reserve Bank of India
Central Office
Bombay – 1
Enc: 1

Lok Sabha

Unstarred Question No. 2603

To be answered on the 18th June, 1971/ Jyaisth 28, 1893 (Saka)

Diversion of Deposits by Life Insurance Corporation (LIC) and Unit Trust of India (UTI) with Banks

2603. Shri C. Chittibabu:

Will the Minister of Finance be pleased to state:

(a) whether the Life Insurance Corporation of India and the Unit Trust of India

- have been diverting their deposits with the banks to inter-bank call money market;
- (b) whether this withdrawal will affect the liquidity ratio to be maintained by the Banks;
 - (c) whether this action of the Life Insurance Corporation and the Unit Trust of India entering call money market and cornering huge profits, adversely affects the deposit mobilization by the Banks; and
 - (d) if so, the remedial action Government proposes to take in this regard?

Answer

The Minister of Finance

Shri Y.B. Chavan

- (a) Prior to June 1970, the Reserve Bank did not permit payment of interest by scheduled commercial banks on call and short notice deposits to parties other than banking institutions and cooperative banks. From 3 June 1970, the Reserve Bank has permitted the LIC and the Unit Trust to receive interest on call and short notice deposits made by them with banks at rates ruling in the inter-bank call money market.
- (b) No, Sir.
- (c) & (d): As the Scheduled commercial banks can secure call and short notice deposits from the LIC and the UTI in the inter-bank call money market, the quantum of deposit with banks is not adversely affected. The banks, however, have to pay interest to the LIC and the UTI at inter-bank call money market rates which are generally higher than the rates admissible on savings and short-maturity deposits. Thus, the matter is one of adjustment in income and expenditure between two wings of financial bodies, viz. on one side the scheduled commercial banks and, on the other, two long-term financial institutions.

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STATE BANK OF INDIA
CENTRAL OFFICE
BOMBAY
9th July, 1971

Dear Shri Jagannathan

CALL MONEY MARKET
PARTICIPATION CERTIFICATES
NEW BILL MARKET SCHEME

I write briefly to record the gist of our discussions regarding the above items on Saturday, the 26th June:-

Call Money Market

The Reserve Bank of India have examined the position and find that, substantially, the funds placed in the call money market by the Life Insurance Corporation of India and the Unit Trust of India do not represent diversion of funds from bank deposits; in other words, the sum of Rs 35–40 crores so placed in the call money market is an addition to the resources of the market. The authorities have taken the view that these two institutions need not be debarred from operating in the call money market, provided it can be ensured that there is a reasonable maximum on the interest rate at which such funds can be placed. The Unit Trust of India have been consulted and they are agreeable to the imposition of such a maximum; the Reserve Bank will now consult the Life Insurance Corporation of India in this regard.

While reiterating my view that this would amount to the Life Insurance Corporation of India and the Unit Trust of India being treated as preferred depositors who can earn a higher rate of interest on surplus funds than is permissible to the general public under the Reserve Bank of India's directive on deposit rates, it was indicated that, if the authorities had made up their mind, we had nothing more to say. However, it remains to be seen what is the maximum rate of interest that comes to be fixed.

I suggest that we may discuss this matter again after this maximum rate has been tentatively determined, before finalizing the matter.

Participation Certificates New Bill Market Scheme

In answer to my query whether the restriction applicable to the purchase of participation certificates, namely, that these can be purchased only by financial institutions, would apply equally to bills under the new bill market scheme, Dr Hazari indicated that there would be no such restriction.

The same considerations which weighted in favour of the Reserve Bank of India stipulating that transactions in participation certificates should be confined to financial institutions only should, in my humble opinion, apply in the case of bills as well. I am unable to subscribe to the view that the bill market, by itself, is going to add to the volume of funds in the banking system and I would most stoutly oppose any arrangement whereby parties with surplus funds in the 'specified centres' can divert deposits from banks to purchase bills from banks, and thereby earn a higher return than is permitted by the deposit rates directive of the Reserve Bank of India. In our social set-up, I would submit that it is the large body of small depositors that need the opportunity for a better return and not the large business houses or other wealthy parties with substantial idle funds.

Instances have come to light where parties have been able to buy bills from other banks (presently some of the foreign banks) at rates up to 7.5 per cent, or even higher, for bills with maturities of between 90 and 180 days. Apart from the fact that this does not, in any way, amount to adding to the resources of the banking system, it reduces the banking system's requirement for liquidity under the law or in terms of your directives.

I returned with the impression that you are going to have this aspect thoroughly examined in the Reserve Bank. I would request that this be done early.

With best regards,

Yours sincerely,
R.K. TALWAR

Shri S. Jagannathan
Governor
Reserve Bank of India
Central Office
Bombay

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D.O.DBOD.No.CAS.502/C.446-72

May 25, 1972

Dear Dr Patel,

CREDIT AUTHORIZATION SCHEME

As Government are aware, the above Scheme was introduced by the Reserve Bank in November 1965 with the object of more closely aligning the growth of bank credit to the requirements of the Plan and as an additional measure of credit regulation. (You will recollect that conditions were then very difficult as would be brought out by various indicators including the fact that the Bank rate was put up twice in succession in September 1964 and February 1965; there were heavy drawings from the IMF in 1965 and again in 1966.) The cut-off point for the purposes of obtaining our prior authorization by scheduled commercial banks for granting additional credit limits was then fixed at Rs 1 crore. In fixing this cut-off point, the Bank took in view that there were then about 650 borrowers having credit limits of Rs 1 crore or more from the banking system as a whole, and it was felt that the purpose in view would, by and large, be served by regulating the flow of bank credit to this category of borrowers. As regards the scrutiny of the applications received for our prior authorization, it was then being done mainly with regard to the purpose for which the limits were sought, and in this connection the banks' statements were relied upon. During the course of the administration of the Scheme, it was observed that banks were not generally appraising the credit proposals with sufficient degree of rigour, nor were they always imposing the necessary financial discipline on the borrowers so as to obviate bank funds being diverted by borrowers for purposes other than their genuine requirements. The need was, therefore, felt for placing the appraisal procedures obtaining in banks on a more systematic basis so as to prevent the borrowers from misusing bank funds. Accordingly, we had, in June 1970, introduced a comprehensive set of forms which would help banks in credit appraisal and also make the regulatory system a more effective mechanism for ensuring the end-use of bank credit. We have, at present, left some discretion to banks for granting, without our prior authorization, certain categories of advance.

2. Since the time when the Scheme was introduced, there has been a considerable development of the economy. Further, with the rationalization of the credit appraisal procedures and the familiarity which banks now have with our present requirement of information regarding the borrowers, they can be expected to lend now on the basis of credit appraisal and the actual needs of the borrowers, and also impose financial discipline so as to prevent misuse of the funds made available to them. In the light of the need for stimulating industrial expansion and investment, and against the background of Government's recent measures to this end, we feel that any measures that we might take to expedite credit sanctions by banks would be useful. In view of the above, it is felt that the area of discretion within which banks could act, though still under our supervision but without our *prior* authorization, could be widened. We are, therefore, thinking of allowing further discretion to banks in the matter of granting credit limits, without our prior authorization, to the individual parties till their credit limits from the banking system as a whole reach Rs 2 crores (including those in the exempted categories), but the grant of such facilities would be subject to subsequent ratification by the Reserve Bank. The proposed cut-off point of Rs 2 cores in regard to the discretion to banks would appear to be reasonable in view also of the substantial expansion in scheduled commercial bank credit which now stands at Rs 5241 crores as against Rs 2020 crores as at the time of introduction of the Scheme, the increase in the number of parties covered by the Scheme from 650 to over 1000 and, more than these, having regard to the experience that the banks have of the Reserve Bank's credit appraisal and credit authorization procedures, and the experience that the Reserve Bank has acquired of the present standard of scrutiny by the banks. It is also felt that the above proposal would not be a 'carte blanche' to banks as we propose advising them that the grant of these facilities would be subject to the subsequent ratification by the Reserve Bank, and where the Bank feels that the enhancement in limits/ additional limits are not warranted or are warranted only to a lower extent, the concerned banks will have to arrange for the cancellation of such limits or for suitable reduction therein. We would, thus, be able to watch the exercise of their discretion to ensure that it is in consonance with the present criteria of the Reserve Bank. The sanction of credit limits to the individual parties in excess of Rs 2 crores would, in any event, continue to be subject to our prior authorization except that, over and above this level, we propose to allow the banks to grant additional facilities up to 10 per cent of the authorized limits or Rs 20 lakhs, whichever is lower, for genuine productive/trade operations, provided the party is not already having such facilities from other bank(s).

3. As regards the grant of the term loans by banks, the instructions issued to them in terms of paragraph 9 of the guidelines enclosed with Government's letter No. F.1 (72)-Corp/69 dated the 9th June 1971 to the Vice-Chairman of the Industrial Development Bank of India would continue to be in force, and no change therein is contemplated.

4. We shall be glad to have Government's views on the proposals made above.
With kind regards,

Yours sincerely,
R.K. HAZARI

Dr I.G. Patel
Secretary
Government of India
Ministry of Finance
Department of Economic Affairs
New Delhi – 1

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May 25, 1972

D.O.DBOD.No.CAS.501/C.446-72

Dear Shri Bhide,

CREDIT AUTHORIZATION SCHEME

As Government are aware, the above Scheme was introduced by the Reserve Bank in November 1965 with the object of more closely aligning the growth of bank credit to the requirements of the Plan, and as an additional measure of credit regulation. (You will recollect that conditions were then very difficult as would be brought out by various indicators including the fact that the Bank rate was put up twice in succession in September 1964 and February 1965; there were heavy drawings from the IMF in 1965 and again in 1966.) The cut-off point for the purposes of obtaining our prior authorization by scheduled commercial banks for granting additional credit limits was then fixed at Rs 1 crore. In fixing this cut-off point, the Bank took in view that there were then about 650 borrowers having credit limits of Rs 1 crore or more from the banking system as a whole, and it was felt that the purpose in view would, by and large, be served by regulating the flow of bank credit to this category of borrowers. As regards the scrutiny of the applications received for our prior authorization, it was then being done mainly with regard to the purpose for which the limits were sought, and in this connection the banks' statements were relied upon. During the course of the administration of the Scheme, it was observed that banks were not generally appraising the credit proposals with sufficient degree of rigour, nor were they always imposing the necessary financial discipline on the borrowers so as to obviate bank funds being diverted by borrowers for purposes other than their genuine requirements. The need was, therefore, felt for placing the appraisal procedures obtaining in banks on a more systematic basis so as to prevent the borrowers from misusing bank funds. Accordingly, we had, in June 1970, introduced a comprehensive set of forms which would help banks in credit appraisal and also make the regulatory system a more effective mechanism for ensuring the end-use of bank credit. We have, at present, left some discretion to banks for

granting, without our prior authorization, certain categories of advances (vide list attached).

2. Since the time when the Scheme was introduced, there has been a considerable development of the economy. Further, with the rationalization of the credit appraisal procedures and the familiarity which banks now have with our present requirement of information regarding the borrowers, they can be expected to lend now on the basis of credit appraisal and the actual needs of the borrowers and also impose financial discipline so as to prevent misuse of the funds made available to them. In the light of the need for stimulating industrial expansion and investment, and against the background of Government's recent measures to this end, we feel that any measures that we might take to expedite credit sanctions by banks would be useful. In view of the above, it is felt that the area of discretion within which banks could act, though still under our supervision but without our *prior* authorization, could be widened. We are, therefore, thinking of allowing further discretion to banks in the matter of granting credit limits, without our prior authorization, to the individual parties till their credit limits from the banking system as a whole reach Rs 2 crores (including those in the exempted categories), but the grant of such facilities would be subject to subsequent ratification by the Reserve Bank. The proposed cut-off point of Rs 2 crores in regard to the discretion to banks would appear to be reasonable in view also of the substantial expansion in scheduled commercial bank credit which now stands at Rs 5241 crores as against Rs 2020 crores as at the time of introduction of the Scheme, the increase in the number of parties covered by the Scheme from 650 to over 1000 and, more than these, having regard to the experience that the banks have of the Reserve Bank's credit appraisal and credit authorization procedures and the experience that the Reserve Bank has acquired of the present standard of scrutiny by the banks. It is also felt that the above proposal would not be a 'carte blanche' to banks as we propose advising them that the grant of these facilities would be subject to the subsequent ratification by the Reserve Bank and where the Bank feels that the enhancement in limits/additional limits are not warranted or are warranted only to a lower extent, the concerned banks will have to arrange for the cancellation of such limits or for suitable reduction therein. We would, thus, be able to watch the exercise of their discretion to ensure that it is in consonance with the present criteria of the Reserve Bank. The sanction of credit limits to the individual parties in excess of Rs 2 crores would, in any event, continue to be subject to our prior authorization except that, over and above this level, we propose to allow the banks to grant additional facilities up to 10 per cent of the authorized limits or Rs 20 lakhs, whichever is lower, for genuine productive/trade operations, provided the party is not already having such facilities from other bank(s).

3. As regards the grant of the term loans by banks, the instructions issued to them in terms of paragraph 9 of the guidelines enclosed with Government's letter No. F.1 (72)—Corp/69 dated the 9th June 1971 to the Vice-Chairman of the Industrial Development Bank of India would continue to be in force, and no change therein is contemplated.

4. We shall be glad to have Government's views on the proposals made above.
 5. We have also separately written to Dr I.G. Patel for his views in the matter.
 With kind regards,

Yours sincerely,
 R.K. HAZARI

Shri V.M. Bhide
 Additional Secretary
 Government of India
 Ministry of Finance
 Department of Banking
 New Delhi – 1

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V.M. Bhide
 Additional Secretary
 DD No: 17(46)/72-CP

Ministry of Finance
 Department of Bank
 'Jeevan Deep' Parliament Street
 New Delhi
 December 11, 1972

Dear Dr Hazari,

You are already aware of persistent demands of the Electricity Boards for funds from the nationalized banks. A study of the bank credit for State Electricity Boards has been attempted in the Department of Banking, a copy of which is enclosed. I shall be grateful for your comments and suggestions on the subject.

With kind regards,

Yours sincerely,
 V.M. BHIDE

Dr R.K. Hazari
 Deputy Governor
 Reserve Bank of India (Central Office)
 Bombay – 1

Enco: 1

Government of India
 Ministry of Finance
 Department of Banking
 Development Division

Sub: Bank Credit for State Electricity Boards

This note seeks to examine the question of extending bank credit to the State Electricity Boards for financing their operations. While the various issues are examined in the first 6 sections, the conclusion that emerge in these sections are briefly summarized in section 7. The basic revenue account data of the 15 State'

Electricity Boards taken together for the years 1968–69 to 1972–73 are presented in Annexure I . . . The data has been culled out from different sources—resources statements of the State Electricity Boards, the report of the power economy committee, etc. Some of the data are not strictly comparable but the differences are not such as to vitiate the arguments.

Section I

1. At the commencement of the current year, the total block capital of the State Electricity Boards was Rs 3,851 crores. While exact figures of the capital in use are not readily available, it can be placed at about two-third of the block capital or roughly Rs 2,700 crores. The total energy anticipated to be generated during the year is 57,000 million KWH, of which line losses will account for about 10,000 million KWH. Thus, the energy likely to be sold (consumed) will be about 47,000 million KWH and the total revenue likely to be realized Rs 588.55 crores. The average receipt per unit will be 12.6 paise for the systems as a whole, the range for the individual boards extending from 7.7 paise for Mysore to 19.2 paise for Madhya Pradesh. It cannot, however, be inferred that a higher average automatically implies higher tariffs as the higher average could also be due to higher proportion of consumption in the domestic and commercial sectors, for which the rates of tariff are generally high and lower proportion of consumption in the agriculture and industries sector for which the tariffs are generally low.

2. The total expenditure on establishment charges, cost of fuel, cost of power purchase, etc. is placed at Rs 333.22 crores, this representing nearly 57 per cent of the total revenue receipts. Here again, considerable variation is noticed from board to board, the range being from 40 per cent in the case of Punjab to 68 per cent for Maharashtra.

3. For purposes of our analysis, the crucial figure is the balance of revenue receipts available after meeting the expenditure on establishment charges, fuel charges and cost of power purchase. This has been termed as the gross operating surplus and represents the amount available with the Electricity Boards for payment of interest charges as well as for being credited to depreciation and other reserve funds, as also for the sinking and loan resumption funds. Except for a small amount that is drawn upon for capital maintenance from the depreciation reserve fund, almost the entire balance in these funds is generally available as a capital resource for the Electricity Board; this amount can be utilized either for plan financing or for repayment of loans. Thus, the gross operating surplus really determines the capacity of a board to pay interest charges as well as pay installments on the loans that it may take from commercial banks.

4. As will be seen from Statement No. 1 the gross operating surplus expressed as a proportion of the block capital at the beginning of the year is likely to be a little less than 6.7 per cent in the current year. Since the percentage was somewhat higher in 1968–69 (7 per cent) and there has been a steady decline over the last few years, it is clear, given the present framework of functioning of these boards, that the proportion is not likely to improve substantially in the next two or three years. Since the interest arrears now is of the order of Rs 50 crores per annum and the

cumulative interest arrears work out to over Rs 350 crores, a substantial improvement in the gross operating surplus position is called for if the Boards are to meet the interest liability in full. It should be noted here that, at present, bulk of the borrowings of the Boards are at fairly low rates of interest of 7 per cent and less.

5. If in calculating this proportion works in progress are excluded, then the percentage of gross operating surplus to the capital base works out to little more than 10 per cent. The return in the margin, that is, on new project cannot normally exceed this figures as, because of the escalation in costs particularly after devaluation, the cost of new projects for a given installed capacity is likely to be very much higher now than in the past. Actually, the return in the margin is likely to be closer to 7 per cent as the proportion of the construction period to the total current currency of the loan that may be obtained for financing the new project may not be much different from the proportion of the works in progress to the total capital outlay. In other words, it can be assumed, that given the present working conditions of the boards, the rate of return on new projects, that is, the proportion of the gross operating surplus to the capital cost of the new project, may not be appreciably more than 7 per cent.

6. If banks are to extend credit facilities to the Electricity Boards, then having regard to the current borrowing rate as well as the need for liquidity, the interest rates will have to be at least 9 to 10 per cent and the period of repayment of the loan can be stretched to a maximum of about ten years, with a moratorium for the first three years. To comply with these conditions, the working of the Electricity Boards would have to be such as to generate a minimum gross operating surplus of about 23 per cent—to cover repayment liability, interest charges and also to meet a certain minimum expenditure on the revenue account itself on maintenance. Since, however, the gross operating surplus is not likely to be much in excess of about 7 per cent of the capital outlay, it is clear that Electricity Boards cannot be considered to be financially viable from the banks' point of view. No doubt, individual schemes of generation or transmission could be shown to work at better results, by ascribing to these schemes, the entire additional revenue likely to be realized as a result of those and other programmes. But then, this would result in a correspondingly lower rate of return on the other programmes, so long as the total profit and loss position for the board does not show any radical changes, and to this extent, the capacity of the Electricity Boards to pay interest on existing borrowings will get reduced. Thus no individual programme, either of generation or transmission and distribution or rural electrification of the Electricity Boards can be considered as a bankable proposition for which credit could be extended at the usual rates.

7. This conclusion which has been arrived at on the basis of certain overall figures holds good for most of the individual boards. As will be seen from the figures given in Annexure II, the gross operating surplus expressed as a percentage of the block capital is likely to vary in the current year from 3.14 per cent (Assam) to 13.01 per cent (Madhya Pradesh). Apart from Madhya Pradesh, the only other Electricity Boards which are likely to have a percentage substantially higher than the all-board average are Gujarat (9.58 per cent) and Andhra Pradesh (8.14 per cent). Even in

these cases, the return cannot be considered to be sufficiently high from a strictly bankers' point of view.

Section II

8. The present inefficient operation of the Electricity Boards is attributable to several factors. On the one hand, the tariff for industrial and agricultural uses continues to be very low and completely out of alignment with the present cost structures. At the time of the plan discussions, the Planning Commission makes suitable suggestions for upward revision of tariff and also sets targets for the achievement during the plan period. Experience has, however, shown that not many Electricity Boards generally achieve the targets. To the extent the Electricity Boards keep on adding to their capital base, while at the same time retaining the rates fixed on an earlier date without any substantial revision, their working will result in greater and greater losses. It is, therefore, very necessary that all efforts are taken to ensure that the Electricity Boards adhere to the targets for additional mobilization of resources.

9. On the other side, the unsatisfactory position can also be attributed to the low load factor and high line losses due the absence of grids and proper systems development. The Power Economy Committee which had examined these issues in great detail has made several recommendations in its report submitted in March 1971. The Committee had estimated that if full integrated operations of power systems throughout the country could be achieved by 1980–81, a net saving in capital expenditure of the order of Rs 300 crores can be achieved. If only integrated operations were available, the saving in fuel charges even in 1968–69 in the Southern Region alone would have been around Rs 8.27 crores. The Committee has also estimated that if adequate advance action, by way of necessary investigation of hydro stations and arrangement for fuel supplies and transport had been taken at appropriate times, it would have been possible to achieve the most economic mix of energy sources with the necessary hydro capacity, and if only this has been achieved, it would have been possible to generate additional revenue of the order of Rs 180 crores at the prevailing tariffs during the 4th Five Year Plan. The Committee has also pointed out that by adopting standardization of designs, specifications, materials and construction practices, a saving of about 15 per cent could have been effected in the capital cost of rural electrification. Further, through proper systems development, the line losses could be reduced substantially and at current tariffs and levels of generation each per cent saved in line losses would result in an additional revenue of Rs 7 crores per annum.

10. A determined effort will have to be made to achieve a balance between hydro stations on the one hand and thermal and nuclear stations on the other, so that the latter category of stations are used mainly as base load stations and hydel stations are used more as peaking stations. Considerable investment will also have to be made in transmission and distribution so as to bring about regional and national grids. Systems development would also have to be attended to on a priority basis so as to reduce line losses. The gap between peak and trough demands would have to

be reduced gradually by promoting more intensive use of power for night shifts in the industrial undertakings (if necessary through incentives by way of reduced tariff) and also for more intensive use of power in the rural areas, both for domestic and industrial purposes. Otherwise, with the present stress on connecting more and more pumpsets to power, the gap between peak and trough demands in the rural areas will become very wide as the pumpsets are operated only during certain periods, and even during these periods only during certain fixed hours of the day.

11. All those efforts for improving the operational efficiency of the Electricity Boards, if these are to be effective, would have to form part of a comprehensive plan which strikes a balance between investments in generation, transmission and distribution, systems development and Rural Electrification. Such an integrated plan might naturally call for much larger outlay and power schemes in the Vth and VIth plan periods than what could possibly be accommodated within the plan ceilings. In fact, it is to some extent due to paucity of funds and the perpetual pressure for new generating stations to meet the increasing peak demand, that the programmes of transmission, distribution and systems development has suffered in the past. The same problem is likely to be faced in the Vth and VIth plan periods as well. Since, at least, in the immediate future, the present comfortable deposit surplus position (not so very comfortable from the Banks' point of view) is likely to continue, it could be examined whether the power outlay could not be fixed at higher level taking credit for the flow of a larger quantum of Bank funds than in past. Whatever amount is finally decided upon could be treated as plan/resources, even as borrowings from the open market and LIC figure now. This way not only will a bigger power plan be possible but it could also be ensured that the flow of Bank credit for power programmes in different regions conforms to the national policy regarding disbursement of public sector investment and reduction of regional imbalances. It will, however, be advantageous, if bulk of the amount flows to the Electricity Boards not as subscriptions to debentures but as term loans for specific schemes, and also if the availability of such funds could be linked to certain targets for revision of tariff and improvement in efficiency. Apart from securing a larger return for the Banks, such an active association of the Banks in the implementation of individual schemes might introduce an element of discipline in the functioning of the Electricity Boards.

12. It is however doubtful, whether even with the implementation of such a comprehensive plan the working of the electricity boards would improve, in the short run, to such an extent so as to make their schemes fully financially viable. Some relaxation in the terms of lending by Banks would therefore be necessary, not so much in the rate of interest as in the period of repayment. The currency of the loan will have to be a long-term one, stretching over a ten-to-twelve-year period with a moratorium for the first three years. The resultant loss of liquidity will be more than offset by the increased interest rate (compared to what they would have got by subscribing to open market loans).

13. All power scheme involve large outlays and under the arrangements outlined in the earlier paragraphs, the question of taking those up for implementation outside the framework of the plan will not arise and consequently the flow of bank credit to

Electricity Boards for financing schemes outside the framework of the plan will stop completely. The Banks would, however, have to land adequate support to the Electricity Boards towards working capital requirements, ways and means, advance, making advance payments on equipment, bridging finance, etc., and this assistance would have to be outside the framework of the plan. Then there is also the question whether Banks should finance rural electrification programmes outside the framework of the plan. These issues are dealt with in the subsequent sections.

Section III

14. The rural electrification schemes pose some special problems and deserve to be examined separately. For one thing, with the increasing emphasis on energization of pumpsets, the State Governments are keen on the implementation of more and more of these schemes and because of the limitation of funds in the plan, quite naturally assistance is sought from the Rural Electricity Corporation and commercial banks. Again, compared to the other power programmes, these schemes have lesser gestation periods and what is more could be conceived, so to say, on the spot depending upon the availability of funds. As a result, over the last few years, a number of rural electrification schemes have been formulated outside the plan framework and taken up for implementation with assistance from the Rural Electricity Corporation or the commercial banks. As will be seen from Annexure IV in which the operation of the REC are briefly reviewed, so far the Corporation has sanctioned Rs 167 crores for 293 schemes, the amount actually disbursed being around Rs 67 crores. The public sector banks, on their part, have sanctioned limits aggregating to about Rs 65 crores for such schemes. Generally, the banks finance such schemes on a consortium basis after the scheme for an area as a whole is cleared from the technical angle by the Agricultural Finance Corporation. The terms of repayment offered by the Rural Electricity Corporation are very much more favourable than those offered by the banks, both in the rate of interest as well as period of repayment.

15. Several shortcomings are noticed in the present arrangements whereby banks extend finance for rural electrification schemes. Firstly, there is very little examination of the merits of the proposals and banks sanction the funds asked for on the basis of the clearance of the AFC on the technical side and the guarantee of the State Governments on the financial side. Local pressures, in some cases a genuine desire to lend more in lead districts, and surplus funds position are some of the factors that have contributed to the somewhat indiscriminate lending by the banks for these schemes and in the absence of a coordinating agency, differing patterns of financing have emerged and undercutting in interest rates is also not uncommon. If these borrowings had not been exempted from the credit authorization scheme, then at least the Reserve Bank of India would have been in the picture. There would not only have been greater scrutiny of the schemes—the mere filling up of the various forms prescribed under the credit authorization schemes would throw up several crucial pointers regarding the financial viability of the schemes—but there would also have been a certain uniformity in the procedures and practices followed by the commercial banks.

16. Secondly, in some cases the cost of 22 KV lines, transformers, etc. are also

included as part of the outlay on these rural electrification schemes, even though these items should legitimately form part of the plan programmes. Generally, only the cost of the lines which are to be borne by the farmer-customers and also to some extent, the feeder lines to the points from where farmers are to take the connection should be included under the schemes. Perhaps, this is one reason why many of the Electricity Boards seek more and more funds from commercial banks for their rural electrification programmes, rather than from the Rural Electricity Corporation which offers much more favourable terms.

17. Thirdly, the borrowal of such short-medium term funds at about 10 per cent interest rate from banks for financing rural electrification schemes could ruin the Electricity Boards financially. The working of the Boards is such that they default in the payment of interest to State Governments even when the loans taken from the State Governments carry comparatively lower interest rates. Such loans are also generally not repayable. To the extent the Electricity Boards seek to fulfil the terms of borrowings from the banks, they would be forced to default more in the payment of interest to the State Governments on the revenue account and also contribute less towards the financing of plan schemes on the capital account. The Planning Commission who were consulted for their views on the entire question of bank credit for power programmes are yet to give us their final views. But what they have said in the interim reply more than supports the points made above regarding financing of rural electrification programmes. The relevant sentences are extracted below:

‘You would be aware that investment on rural electrification does not bring any significant return to the Electricity Boards, but on the other hand involves appreciable losses even on long-term basis. Therefore, financing rural electrification programmes through short-term loans at high interest rates would result in erosion of the resources of the State Electricity Boards and reduce their capabilities for financing their other capital programmes.’

18. Fourthly, to the extent a large number of rural electrification programmes aimed at energizing pumpsets are formulated outside the framework of the plan, it would become increasingly difficult to plan properly for striking a balance between the supply and demand for pumpsets.

19. Lastly, the laissez-faire conditions that now seem to govern these lendings by the banks have only tended to increase the regional imbalance in the investment of bank funds. Out of the Rs 150 crores sanctioned by the banks, so far, to the Electricity Boards for rural electrification and other purposes, Maharashtra state alone accounts for Rs 50 crores while the borrowings by Tamil Nadu exceeds Rs 20 crores.

20. The only way to avoid these unhealthy trends would be to stipulate that all rural electrification schemes should also figure as part of the plan programmes so that the Planning Commission is able to take an overall view. Banks should most certainly finance such schemes; but their lending should be within the framework of the plan policy as settled by the Planning Commission and should be governed by the principles set out in Section II. Since these new arrangements can possibly be introduced only as part of the 5th Five Year Plan, it could be considered, whether

in the meantime, such lendings should not be brought under the purview of the credit authorization scheme, with immediate effect so that, at least, the RBI could act as a coordinating agency and as a sobering influence.

Section IV

21. The Electricity Boards now seek assistance from banks for making advance payments for purchase of equipment, for tiding over ways and means problems, for bridging finance, for working capital, etc. To some extent, these demands are quite justified. Generally, the outlay on power programmes as proposed by the Electricity Boards and the State Governments far exceed the resources insights. These outlays are pruned considerably by the Planning Commission during the plan discussions and even for financing the outlays so pruned the resources of the Electricity Boards have to be stretched to the maximum. This arrangement does not leave any margin with the State Electricity Boards for working capital requirements or for meeting unforeseen expenses. The difficulties get accentuated, when, as usually happens, the investment exceeds the approved outlay and the generation of internal resources falls short of the targets, thus creating severe ways and means problems. In the circumstances, it is but natural that the Electricity Boards should look to the banks, who function as their bankers, for meeting these requirements. In fact, the banks have even now sanctioned limits aggregating to over Rs 80 crores to the Electricity Board for such purposes.

22. But the present arrangements for the sanctioning of such advances have led to the emergence of two unhealthy trends. The first, as earlier indicated, is the uneven geographical distribution of these facilities, with two or three States accounting for bulk of the advances. The second and perhaps the more important trend is the tendency on the part of some of the Electricity Boards to utilize such short-term borrowings for financing larger power outlays than what has been approved. In some cases, these borrowings are also utilized to cover up for the shortfall in the generation of internal resources. It will, therefore, be desirable to lay down some criteria to govern such advances and thereby guard against the misuses of these facilities. The following suggestions could be considered in this regard:

- (a) For each Electricity Board, a limit should be fixed—say 5 per cent of the annual revenues—for the borrowing from the banking industry as a whole towards working capital, cash credit accommodation, ways and means advances, etc.
- (b) Advance payment requirements as well as advance action outlays are usually provided for, as part of the plan outlay. In some cases, the demand may however arise before the finalizing of the plan outlays. In such cases, the banks can extend bridging finance to meet the requirement, provided there is a clear indication from the Electricity Boards and the Planning Commission that these requirements figure as part of the plan programmes and that the funds required will be provided in the next year's budget. Thus, in such cases, the currency of the bridging finance will extend up to the commencement of the next financial year only.
- (c) Sometimes, the delay in the receipt of promised assistance from State

Governments, LIC, etc. puts the Electricity Boards in difficulty. In genuine cases of this type, the banks could give bridging finances for such periods, extending up to the time of realization of the promised assistance.

- (d) These borrowings can also be brought within the ambit of the credit authorization scheme.

Section V

23. Another facility now enjoyed by the Electricity Boards is the IDBI's scheme of rediscounting of bills relating to purchase of equipments for which a limit of Rs 1 crore has been set for each Electricity Board. The utilization of this facility so far is rather poor because the effective rate of interest is rather high being 11 per cent or more. Actually, the rediscounting rate is only 6 per cent and the difference represents bank charges, stamp duty, etc. The Maharashtra State Electricity Board has, to some extent, got over this difficulty by insisting on suppliers discounting the bills with the Board's bankers who had quite naturally agreed to waive the commission in view of the large business transactions of the Board with them. The other Electricity Boards could also follow this example and thus obtain some financial relief. But steps should be taken to ensure that this facility of rediscounting does not amount to double financing in favour of the Electricity Boards.

Section VI

24. We then come to another important issue, the one relating to the payments for the supply of plant and equipment by the Bharat Heavy Electricals Ltd and Heavy Electricals (India) Ltd. Recently, the procedure for making such advance payments had been changed and whereas hitherto the Electricity Boards had to pay as much as 50 per cent as advance, they are now required to pay only 10 per cent. The change in the procedure, while providing considerable relief to the Electricity Boards would shift the burden on to the BHEL and HEIL and push up their working capital and cash credit requirements. As will be seen from the details furnished in Annexure V, this additional requirement of BHEL and HEIL is likely to be quite large and it will be appropriate if a consortium of banks rather than a single bank could meet this demand. Any assistance provided this way will ultimately go to help the Electricity Boards as, so long as these two public sector undertakings are able to obtain their working capital requirements in full, they are not likely to insist on larger advance payments from Electricity Boards. The detailed proposals which these two public sector undertakings might submit to the Planning Commission to the Ministry of Irrigation and Power regarding their requirement of additional working capital and cash credit requirements would have to be examined in our Department very carefully, if necessary, in consultation with select Custodians. Our approach should be one of cooperation to ensure that the banking industry meets, in full, the requirements of these two public sector undertakings.

Section VII

25. To sum up, the suggestions made in this note are:

- (i) The outlay on all power schemes as well as funds required for making advance payments or for taking advance action should be provided as part of the annual and Five Year Plans. While the banking industry could definitely contribute to financing a part of the power plans, it will be desirable if bulk of their contribution takes the shape of medium- and long-term loans for financing specific programmes rather than as subscriptions to the open market debentures floated by the Electricity Boards. However, whether the banks should extend credit for meeting a part of the outlay on power programmes and if so, to what extent is a matter for the Planning Commission to take a decision in consultation with us. They have already been addressed for their views and now they could be requested to expedite their decision so that if the banks are to finance part of the plan outlay then this decision could form part of the 5th Five Year Plan strategy for financing power programmes.
- (ii) The banks could provide bridging finance to meet advance payments as well as outlays on advance action; but such bridging finance should be extended only on the basis of a clear assurance from the Electricity Boards and the Planning Commission that the schemes for which the funds are sought form part of the plan programmes and also that the required amount will be provided in the budget for the next financial year. The currency of the loan given would extend up to the commencement of the next financial year. The banks could also extend bridging finance for short duration against promised assistance from the State Governments, LIC, etc. where there is delay in the realization of these amounts.
- (iii) Banks operating as bankers for Electricity Boards may extend cash credit, working capital required, ways and means advances, etc. to the Boards. The banks should, however, scrutinize the proposals closely and satisfy themselves of the genuineness of the demand so as to guard against the possibility of such short-term advances being misutilized for financing larger plan outlay or for covering up the shortfall in generation of internal resources. A ceiling should also be prescribed on the borrowings by each Electricity Board from the banking sector as a whole. The limit could be 5 per cent of the total annual revenue of each Board.
- (iv) All rural electrification programmes should be taken up for implementation as part of the annual and Five Year Plans only. Bank finances for such schemes should be within the framework of the plan programmes and governed by the considerations set out under suggestion (i). Till such time as a new arrangement is brought into force, advances for rural electrification schemes should be subject to the clearance of the RBI by being brought within the purview of the credit authorization scheme. This will also apply to the advances mentioned under (ii) and (iii).

- (v) Steps should be taken to enable the Electricity Boards to take full advantage of the bill rediscounting scheme drawn up by the IDBI; it must also simultaneously be ensured that this does not result in double financing in favour of the Electricity Boards.
- (vi) The additional working capital and cash credit requirement for BHEL and HEIL should be met in full by the banking industry, preferably on a consortium basis. This matter should be pursued with the Planning Commission and the two organizations concerned.

26. Incidentally, earlier this year we had called for the views of the public sector banks on these issues. In our letter, we had suggested that perhaps it would be better if commercial banks do not advance monies directly for financing schemes and that their assistance could be limited to subscription to debentures and to provision of short-term loans towards bridging finance, ways and means requirements, etc. The banks have, by and large, endorsed these views.

ANNEXURE I

State Electricity Boards Analysis of Revenue Accounts

(Rs in crores)

Item	1968-69 Accounts	1969-70 Accounts	1970-71 Estimates	1971-72 Estimates	1972-73 Estimates
1. Block capital at the beginning of the year	2206.46	2570.42	2994.52	3465.39	3851.63
2. Total Revenue Receipts	333.32	390.88	454.09	518.36	588.55
3. Working expenses	180.49	217.53	259.29	287.16	333.22
4. Ratio of working expenses	54.15%	55.65%	57.10%	55.40%	56.90%
5. Gross operating surplus (item 2 to item 3)	152.83	173.35	194.80	231.20	255.33
6. Rate of return on Block Capitals (Ratio of item 5 to item 1)	6.92%	6.75%	6.60%	6.67%	6.66%
7. Contribution to reserves	61.18	77.00	87.46	104.39	111.84
8. Interest liability	110.54	124.73	150.17	175.14	193.89
9. Interest arrears during the year, i.e. amount not paid for want of resources	18.89	29.38	42.83	48.73	50.00

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D.O.No.CPC. 777/212-72/73

29 January 1973

Dear Shri Bhide,

Further to my D.O. dated December 14, 1972, I enclose a brief note setting out our comments on the principal issues raised in the note of your department on bank credit for electricity boards. Rather than issue another set of guidelines to the banks, we would prefer an informal arrangement by which banks would consult us

regarding the proposals received by them from State Electricity Boards before finalizing the terms and conditions.

With kind regards,

Yours sincerely,
R.K. HAZARI

Encl:

Shri V.M. Bhide
Additional Secretary
Department of Banking
Ministry of Finance
Government of India
New Delhi

BANK CREDIT FOR STATE ELECTRICITY BOARDS

The Banking Department's note on Bank Credit for State Electricity Boards admits that programme for power transmission and distribution and systems development have suffered for lack of funds and are likely to so suffer in the future as well. It is also admitted that banks have excess liquidity. However, there is a certain reluctance to match these two phenomena. It is felt that Electricity Boards are not viable borrowers from the banks' point of view (para 6). Hence, if banks are to be permitted to lend to Electricity Boards at all, it should be subject to the following conditions:

- (1) Loans for capital outlay should only be for schemes approved by the Planning Commission and included in the Plan.
- (2) Credit for this purpose should be extended in the form of term loans only and not through subscription to debentures.
- (3) Concessions in terms of lending should be in regard to the period of repayment rather than the rate of interest (para 12).
- (4) Whether banks should, at all, extend term credit to Electricity Boards and if so to what extent, is a matter to be decided by the Department of Banking in consultation with the Planning Commission.
- (5) Banks may extend bridging loan for advance payment requirements which could arise before plan outlays are finalized, but only if it is clear that the funds so lent will be reimbursed through budgetary provisions in the following year.
- (6) Working capital required by the Boards could be financed by banks. But an overall ceiling of borrowing from banks is suggested at 5 per cent of the total annual revenue of each Board.
- (7) Bank financing of rural electrification programmes is considered generally undesirable. The suggestion made is that all such programmes should form a part of the Plan with bank financing coming under its framework.
- (8) The credit authorization scheme should be made applicable to lending for (a) rural electrification programme (pending the arrangement suggested); (b) working capital requirements of Electricity Boards; and (c) bridging loans given on an annual basis. This would imply that in respect of term lending to the Boards, the Reserve Bank would not be consulted.

The point is not adequately appreciated that the country now faces a power famine of serious dimensions, and that future development hinges on the build-up of this vital infrastructure. This situation happens to coincide with one of adequate liquidity in the banking system. Even if this were not so, there would seem to be a case for involving banks to a greater extent in the financing of electricity projects. In the present circumstances, it would be little short of gross negligence to allow power schemes to languish for want of finance while banks are unable to find outlets for their resources. The alternative left for putting through the schemes would be through provision of governmental finance—which could mean, ultimately, recourse to the Reserve Bank. It would obviously make more economic sense to allow the turnover of existing liquidity than permit further deficit financing. It would be argued that power projects could be financed through new markets borrowings of State and Central Governments. Banks would certainly be called upon to subscribe to them, but it is clearly unnecessary to adopt this roundabout method of financing to the exclusion of direct lending to the Electricity Boards.

Nor does it seem necessary to obtain the Planning Commission's approval for such proposal made by a State Electricity Board. The Resources Working Group has estimated an addition to bank deposit of Rs 9,130 crores during the 5th Plan period. Of this, about 18 per cent is expected to be pre-empted for subscription to the market borrowings of the Central and State Government, and a further 7 per cent by way of subscription to the bonds of non-financial enterprises (into which category State Electricity Boards would fall). An amount of Rs 1,500 crores (or 16.4 per cent of the increase of deposits) is expected to be provided for the working capital requirements of public sector enterprises. The total contribution of banks to the public sector in the 5th Plan would amount to 42 per cent of the anticipated increase in deposits. There would thus be scope for bank financing of non-plan projects even in the public sector.

The suggestion made that banks' involvement in power programmes should be through term loans rather than exclusively through subscription to bonds, would seem acceptable. For one thing, the direct contact of banks with State Electricity Boards would be beneficial in that it might promote financial discipline and improve their working. Also, this would be a means of improving the credit–deposit ratio in some less-developed States which offer little scope for other lending. At the same time, it has to be recognized that the investment in the bonds of Electricity Boards is not very high, forming only 6.5 per cent of total bank investments in March 1972. As a proportion of investments in State Government securities and securities of State associated/approved bodies, this was 13.3 per cent for the country as a whole, though among individual states it ranged between 6.5 per cent in Maharashtra and 20.1 per cent in Haryana (vide Statement appended).

The distinction drawn in the note between term loans to State Electricity Boards (which would require clearance from the Banking Department and the Planning Commission) and working capital and bridging loans (which would require Reserve

Bank clearance) is somewhat ambivalent. A good portion of the so-called working capital, now being provided, is in actuality utilized to meet medium- and long-term requirements. If it be conceded that lending to State Electricity Boards is desirable in the present context, then what is necessary is an evaluation of each proposal taking into account not only the financial prospects but the overall portfolio of the lending bank and the position of the concerned Board and the power requirements of the State as well. This could be done in an integrated manner in the Reserve Bank, not just under the Credit Authorization Scheme but from the angle of overall credit planning. In the conditions prevailing at present, it should be possible for banks to enter into fairly large scale commitments for financing State Electricity Boards over at least the next two to three years. Thereafter, the share of total credit that could be allocated for electricity projects would have to be decided taking account of the requirements of other sectors and the overall resource position. It might be desirable to set up a consortium arrangement for the distinction of this type of results between banks with the Reserve Bank as coordinator. This would be the best arrangement to take an overall view of the resources of the banking system and then to decide on the size of funds available for electricity boards. This would also eliminate the scope for individual State Electricity Boards to obtain credit in excess of requirements and at concessional terms by playing up the 'competition' between banks.

While it is conceded that lending to State Electricity Boards should not run out of proportion, either in regard to an individual bank's involvement or to an individual Board's reliance on the banking sector, an overall ceiling on bank borrowing as proposed, would be undesirable. The position would clearly vary from Board to Board and a flexible approach is very necessary.

The proposed conditions under which bridging loans may be made appear rather impracticable. At any rate, if the idea of bank lending to State Electricity Boards under Reserve Bank supervision is accepted in principle, individual cases could be examined on merits, without any blanket regulation. The same would apply to loans for rural electrification. Here, a liaison with the Rural Electrification Corporation would be helpful in judging requirements.

The suggestion that concessions in lending should be done in the form of adjustment of repayment schedule rather than in lower rate of interest may not be feasible. While a realistic schedule of repayment, with a maximum 'holiday' is important, State Electricity Boards would also require some concessions in interest rate, which could be around 9 to 9.5 per cent for the present.

The note also includes a reference to the financial requirements of the Bharat Heavy Electricals Ltd. and Heavy Electricals (India) Ltd. A recent change in the procedures relating to the advance payment by Electricity Boards to these industries have enhanced the working capital needs of these undertakings. It is said that their additional working capital requirements would have to be examined in the Banking Department 'very carefully, if necessary in consultation with select custodians'. It

is true that advances to public sector projects are exempt from scrutiny under the Credit Authorization Scheme, but that is no reason why the expert machinery available in Reserve Bank cannot be used for this purpose.

Credit Planning Cell
Reserve Bank of India
Bombay

Bank Investments in Bonds of State Electricity Boards

(Rs lakhs)

	March 1972		(2) as % of (1)
	Investments in State Government securities and securities of State associated approved bodies	Investments in bonds of State Electricity Boards	
	(1)	(2)	(3)
1. Andhra Pradesh	9809	832	8.5
2. Assam	1196	300	25.1
3. Bihar	3238	727	22.5
4. Gujarat	11493	1321	11.5
5. Haryana	2347	706	30.1
6. Kerala	3964	942	23.8
7. Madhya Pradesh	3364	534	15.9
8. Maharashtra	21337	1381	6.5
9. Mysore	9364	1730	18.5
10. Orissa	2314	592	21.0
11. Punjab	4333	753	17.4
12. Rajasthan	4082	630	15.4
13. Tamil Nadu	13115	1742	13.3
14. Uttar Pradesh	7950	1129	14.2
15. West Bengal	5649	701	12.4
Total	104075	14020	13.5
All India	105249@	14020	13.3

@There are no investments in bonds of State Electricity Board in Himachal Pradesh, Jammu & Kashmir, Nagaland, Delhi and other Union Territories.

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J.S. Raj
Chairman

UNIT TRUST OF INDIA
POST BOX NO. 2000
BOMBAY 1
23rd January 1974

D.O.No.UT.5773-5774/NP.8-74

Dear Shri Jagannathan,

AMENDMENTS TO THE UNIT TRUST OF INDIA ACT, 1963

You will please recall the discussion I had with you in June 1972 about the difficulties which the Trust is facing in investing its surplus funds in view of the statutory provisions which, at present, restrict the Trust from investing its monies except in shares, securities or keeping it deposited with scheduled banks or with other approved institutions. While agreeing to promote a suitable amendment to the Act to enable the Trust to invest its surplus funds in loans and other instruments such as participation certificates, bill discounts, etc. approved by the Reserve Bank, you had in your letter dated 14 June 1972 desired that I should put up self-contained proposals to enable you to make a reference to the Government.

2. We have considered various suggestions to amend the Act from time to time in consultation with the Legal Department and had the suggestions also approved by the Board of Trustees. I am now sending you a draft Bill (in triplicate) prepared by the Legal Department on our instructions, containing our proposals for amending the Act. We are also enclosing a statement of objects and notes on clauses of the Bill explaining the various provisions thereof. The matters in respect of which amendments have been suggested are broadly explained below:

(i) *Enlarging the Scope of the Trust's Investments*

At present, the investments of the Trust are statutorily restricted to shares and securities or keeping money on deposit with scheduled banks, etc. It has been the experience of the Trust in recent years that securities of first class companies are not available in sufficient quantities with the result that it is becoming extremely difficult to employ the Trust's funds in profitable outlets. Pending investments of the funds on long-term basis, the Trust takes recourse to Government securities and Call and Short Notice deposits with banks. The rate of return on Government securities is low and they are not, therefore, suitable for investment in view of the obligation of the Trust to pay reasonable dividends to unit holders. Call and Short Notice deposits with banks being by their nature very short-term investments do not generally yield a high return except in unusual times like the present. It is, therefore, necessary to consider some other fields where the Trust can employ its funds, on short-term or long-term basis, more remuneratively. In this connection, I may add that it will be necessary for amendments to the act.

If the Trust can invest in participation certificates or rediscounting of bills, it will be able to earn better yield on its funds. Unlike other term lending institutions, like the Industrial Development Bank of India, Industrial Finance Corporation, Industrial Credit and Investment Corporation of India and Life Insurance

Corporation of India, the Trust is precluded from giving direct loans. In view of this, we have to take recourse to the tortuous procedure of subscribing to privately placed debentures which is time consuming as well as expensive. We, therefore, feel that the Trust should be permitted to give loans directly in addition to subscribing to debentures. Clause 3 of the enclosed draft Bill deals with these amendments.

(ii) *Eligibility for Reappointment of Chairman and Executive Trustee*

A doubt has been raised whether, in the absence of a specific provision in this regard in the Act, an outgoing Chairman or Executive Trustee will be eligible for reappointment. Legal Department have suggested that it will be preferable to amend the Act to place the matter beyond doubt. We are, therefore, suggesting amending Section 14(2) (a) of the Act retrospectively. This is dealt with in clause 2 of the Bill.

(iii) *Restriction on the Use of Words "Unit", "Units" or "Unit Trust" by Persons other than the Trust*

It has been brought to our notice that certain institutions and persons, for example, New Bharat Savings Unit (P) Ltd., Calcutta, Nav Bharat Investments Ltd., Bombay and Gujarat Savings Unit Pvt. Ltd., Bombay are offering investment schemes to the public using the words 'Unit' or 'Units' as part of their names or in their advertisements. As the use of the words 'Unit' and 'Units' is likely to be confused by the public with the units of the Unit Trust of India, we feel it will be desirable to prohibit on the lines of corresponding Section 7 of the Banking Regulation Act, 1949, the use of words 'Unit', 'Units' and 'Unit Trust' by persons offering investment Schemes. Clause 4 of the enclosed Bill proposes insertion of a new section in the Act for this purpose.

(iv) *Provision of Nomination by Unitholders and Agents*

At present, there is no provision in the Act enabling a unitholder to make nomination in respect of the units held by him. This has been a great handicap and a deterrent factor to some extent to investment in units by persons who do not want to take advantage of the provisions for joint holding but would like only to make a nomination. We, therefore, feel that the Act should be amended to permit the Board to include a clause in the Unit Schemes for nomination by unitholders.

It is also felt necessary to have an enabling provision for nomination by sales agents of the Trust in respect of the commission, etc. payable to them on sales of units procured by them. Such a provision is necessary as in the case of Unit-Linked Insurance Plan, commission would be payable over a period of ten years. The facility of nomination would be an additional incentive for the agents. Life Insurance Corporation of India extends a similar benefit to its agents and Section 44(2) of the Insurance Act, 1938, as applicable to Life Insurance Corporation has been modified for this purpose.

The first part of clause 5 of the Bill sets out the amendments.

(v) Investment on Behalf of Minors

We have had the position examined by the Legal Department and also by the Solicitors. The legal position that emerges is that the investment on behalf of a minor is governed by his personal law. In the case of Hindus, the natural guardian is the father and, in the absence of the father, the mother. The mother cannot act as natural guardian so long as the father is alive and is able to act as natural guardian. As regards Muslims, the natural guardian of a minor is the father, the executors appointed by a will by the father, the father's father and executors appointed by his father's father. The mother is not competent to act as natural guardian under any circumstances. Persons who are neither Hindus nor Muslims (for example, Christians and Parsis) are governed by the English Law under which the natural guardian is the father and after the father's death, the mother is the natural guardian only for the purpose of nurturing the child. We have received several applications by working mothers for investment in units on behalf of their minor children which we were unable to accept having regard to the legal position stated above. Therefore, it will be necessary to amend the Act to enable investments in units on behalf of a minor by either parent. The second part of clause 5 of the Bill seeks to insert a new section in the Act for the purpose.

3. We feel that the amendments suggested by us are necessary for the future growth of the unit trust movement in India. We shall, therefore, be glad if the proposed amendments are taken up with the Government for necessary action at a very early date.

With best regards,

Shri S. Jagannathan
Governor
Reserve Bank of India
Bombay – 1

Yours sincerely,
J.S. RAJ

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D.N. Ghosh
Joint Secretary

DEPARTMENT OF BANKING
BANKING VIBHAG
'JEEVAN DEEP'
PARLIAMENT STREET
NEW DELHI
April 6, 1974

Dear Dr Hazari,

This is with regard to certain developments in the money market about which Shri Talwar has made references in the Annual General Meeting of Shareholders at Madras on 29th March, 1974. First, he has referred to the practice of rediscounting of bills, which are not eligible for refinance by the Reserve Bank of India, by approved

financial institutions such as LIC and General Insurance Corporation and has taken the view that this practice militates 'against the spirit of credit curbs', for even when such bills cover the sale and purchase of sensitive commodities, banks can offer such bills to financial institutions with impunity. Further, this helps one set of large depositors to obtain higher return on short-term surpluses.

Secondly, he has questioned the propriety of issuing participation certificates. He mentions that funds obtained by the bank from financial institutions through the medium of participation certificates 'steer clear of the discipline imposed on regular bank deposits. While a bank may lend not more than 60 out of every 100 rupee of its deposits, it remains unhampered in lending the entire amount of Rs 100 derived through participation certificates'. While on this, we would invite a reference to certain other aspects regarding participation certificates which were brought out in our letter of 8th May 1973.

Thirdly, Shri Talwar refers to certain adverse impact on the banking system arising out of the participation of LIC and Unit Trust in the call money market. As the funds of the LIC and Unit Trust would have normally accrued to the banking system in the shape of deposits at the normal rates of interest, there would appear to be little justification, in Shri Talwar's opinion, of getting the funds in a 'roundabout and expensive' way through call money market. The 'gains' as Shri Talwar puts it, 'accruing to Life Insurance Corporation and Unit Trust from the call money market are in the nature of a windfall from a special concession at the expense of the banks'.

We are not offering at this stage any comments on the merits or otherwise of the points raised by Shri Talwar. As Parliament is in session and the Consultative Committee of the Ministry of Finance is also scheduled to meet on 2nd of May 1974, it is not unlikely that the points raised by Shri Talwar may come up for discussion. We shall be grateful if we could have, at your convenience, a detailed brief from the Reserve Bank on the points raised by Shri Talwar and also your advise, in case the points are raised, on the lines on which Finance Minister could deal with them.

Regards,

Dr R.K. Hazari
Deputy Governor
Reserve Bank of India
Central Office
Bombay
KBP:

Yours sincerely,
D.N. GHOSH

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TELEX MESSAGE

For: M.B. Usgaonkar, Under Secretary, FINBANK, New Delhi
From: S.V. Raghavan, DCO, DBOD, RBL, Co, Bombay

Refer your Telex MSG. No. 710 dated 30th April 1974. Our views on Shri R.K. Talwar's observations on Participation Certificates and on the question of participation of LIC and UTI, in the Call Money Market are given below:

Participation Certificates Scheme

Shri Talwar contends that the funds raised by issue of P' Certificates are equivalent to deposits accepted by banks. This contention is not correct. If such funds are treated as deposits they will, no doubt, be subject to our directive on deposit rates. On the other hand, P' Certificates Scheme envisages loan participation and as such, funds derived through issue of P' Certificates are in the nature of refinance obtained from sources other than Reserve Bank of India by the issuing bank up to the extent of 100% of the relative advances. The cumbersome legal formalities adopted by banks in connection with the issue of P' Certificates will themselves testify that these transactions are only loan participations and do not represent another mode of acceptance of deposits. In any case, we have not been treating Participation Certificates as deposits. As already advised in our D.O. letter GCS. No. 142/C. 475-7 dated 7th February 1974, P' Certificates Scheme is on an experimental basis up to the end of June 1974.

Participation of LIC and UTI in the Call Money Market

We do not accept Shri Talwar's view that Money Market should be the exclusive preserve of banks, and that it is not desirable for the LIC and UTI to participate in the Call Money Market. Our reasons are as under:

- i) The LIC and UTI command very large quantum of surplus funds which represent savings of the people. These funds have been collected by the institutions with their own efforts and at their own cost.
- ii) It is not correct to assume that all these surplus funds will necessarily be kept with banks in the form of deposits. The tendency for these institutions would be to secure maximum return on such funds, and as such they may be inclined to keep them even outside the banking system or in other investments.
- iii) The availability of their surplus funds in the Call Money Market tends to reduce banks' resort to the Reserve Bank.
- iv) The Reserve Bank is continuously trying to foster the growth of an active

money market, and in this context it cannot keep outside the market, institutions like LIC and UTI which command very large resources. Their active operation outside the sphere of Money Market might even affect the credit situation in the country and may ultimately prove detrimental to the interests of banks themselves.

v) These institutions cannot be treated on a par with ordinary depositors.

The above thoughts have also been echoed to some extent in the speech delivered by Shri J.N. Saxena, Chairman, Indian Banks' Association at the Annual Meeting of the Association held on 19th April 1974 as under:

'Some criticism has been voiced in this respect with regard to the facility afforded to the Life Insurance Corporation of India and the Unit Trust of India to operate in the money market. . . True, the two institutions are enabled to reap the benefit of the high rates, but the remedy is a ceiling of the nature afore-referred. Also, it would not really be correct to assume that the money that they place with banks at call through the call market would, in any case, be placed by them in current accounts with banks, as they could not possibly afford to keep the funds idle and would naturally look to alternative investment in Treasury Bills.'

S.V. RAGHAVAN
30-04-1974

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TELEX DBOD.GCS.No.
D.O.No. DBOD. TEP.4/C.517-76

July 13, 1976
Asadha 22, 1986 (Saka)

Dear Shri Sen Gupta,

You will remember that while at Bhopal on 19th June 1976, I had told you that Government had recently issued certain instructions to public sector banks directly and we were not even informed about the issue of such instructions, as copies of the relative letters were not endorsed to us. Some of the letters I had in mind are:

1. D.O.No. 20(1)/76-KSA dated the 24th January 1976
2. D.O.No. 2-18/76-AC dated the 15th/19th April 1976
3. D.O.No. 20(1)/76-KSA dated the 17th May 1976
4. No. F. 9/14/76-AC dated the 17th May 1976
5. D.O.No. 4/1/16/75-IR dated the 24th June 1976

We feel that normally instructions to banks should issue from the Reserve Bank. This will not only avoid confusion at the banks, but would also lead to better coordination. In case of any urgency, while Government may write to banks directly, copies of these letters should invariably be endorsed to us. In case Government ask the banks to submit any information/statements to them directly, the banks should also be advised to forward copies of such statements, etc. to us to avoid our writing to them again on the same subject. It is also necessary that copies of all important communications addressed by Government to any bank are endorsed to Reserve Bank.

2. We shall be glad if you will please issue suitable instructions to all concerned and we are advised in the matter.

With kind regards,

Shri N.C. Sen Gupta
Secretary
Department of Revenue and Banking
(Banking Wing)
Government of India
New Delhi

Yours sincerely,
K.S. KRISHNASWAMY

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/C.517-76

Dear Shri Menon,

Please refer to my D.O. letter DBOD. No. TEP. 4/C. 517-76 dated 13th July 1976 addressed to Shri N.C. Sen Gupta, the then Secretary in the Department of Revenue & Banking, regarding communications addressed by Government to public sector banks on matters of importance. While copies of a few letters addressed to such banks direct by Government have been endorsed to us, it has come to our notice that instructions still continue to be issued directly to banks, without consulting us or even informing us about them. For instance, D.O. letter No. 9(1)/73-DEV dated 9th August 1976 was issued by the Department of Revenue and Banking to the Chairman of the lead banks in Bihar State on such an important matter as the strategy of branch banking in the State, and we were not kept informed by the Department notwithstanding the fact that branch banking is regulated by the Reserve Bank under the provisions of the Banking Regulation Act. Another letter bearing No. F. No. 9(7)-76 ESA was issued on 4th September 1976 to the Chairman of the State Bank of India and the nationalized banks on the question of stepping up their lendings to the priority sectors to 33.33 per cent of their total advances by the end of the 5th Five Year Plan. This important communication was also not endorsed to us. We would once again request Government to ensure that there is no communication gap between the Reserve Bank and the Department of Revenue and Banking on such vital matters of policy, and also in other matters and to instruct all the officials concerned suitably in the matter.

With kind regards,

Shri K.P.A. Menon
Addl. Secretary
Deptt. Of Revenue & Banking
(Banking Wing)
Government of India
New Delhi

Yours sincerely,
K.S.K

DIRECTIVES SECTION

PARTICIPATION CERTIFICATES SCHEME—THE LAKSHMI VILAS BANK LTD.

We have, so far, permitted 43 banks (34 Indian and 9 foreign) to issue participation certificates under the above Scheme. The Scheme, which was started on an experimental basis, is being extended from time to time and the present extension is for a further period of one year, that is, up to 30th June 1977. In this connection, it may be stated that the Lakshmi Vilas Bank Ltd., a licensed scheduled bank, is not on the list of approved banks for issue of these certificates. During the course of the inspection of the bank carried out recently, it was observed that it had issued participation certificates to the United India Fire & General Insurance Co. Ltd. without obtaining our approval for entering into such an arrangement. We had, therefore, taken up the matter with the bank, and in reply it has now sought our approval for inclusion of its name under the above Scheme.

The Lakshmi Vilas Bank Ltd. started functioning in the year 1926. Its paid-up capital as on 31.12.1975 stood at Rs 22.88 lakhs as against Rs 20.11 lakhs as at the end of the previous year. It is observed from the last report on the inspection of the bank conducted with reference to its position as on 28th September 1973 that its financial position is sound and its affairs are not being conducted in a manner detrimental to the interests of its present or future depositors. Certain financial data pertaining to the applicant bank is placed below. Its deposits as on 31st December 1975 stood at Rs 18.96 crores as against Rs 17.11 crores at the end of previous year. Its deposits for the week ended on 25th June 1976 amounted to Rs 19.95 crores showing an increase of about Rs 1 crore during the current half-year. Its advances as on date, stood at Rs 11.77 crores.

The bank has stated that due to tight resources position it becomes necessary for it to borrow from approved financial institutions by issuing participation certificates against the working capital advances made by it to industrial concerns. It has explained that it was under such circumstances, that it had to take recourse to the Participation Certificates Scheme by issuing participation certificates to the United Fire & General Insurance Co. Ltd., which had surplus funds available with it, although it had no approval to participate under the scheme. The bank has added that so far it has issued certificates of the order of Rs 20 lakhs to the said company.

Due to the reasons stated above, it may not be possible for the bank to meet the increasing demand of the borrowers from its own resources. If the bank is allowed to enter into participation arrangement with other financial institutions like banks, LIC, UTI, etc., it would help the bank in augmenting its resources and would, in turn, widen the scope of its assistance to the industrial sector. In view of this, we may allow the bank to issue participation certificates to other approved institutions on the usual terms of the Scheme. If approved, the bank will be advised suitably on the usual lines.

29.07.76

DIRECTIVE SECTION
PARTICIPATION CERTIFICATE SCHEME — LAKSHMI VILAS BANK LTD., MADRAS

Ref: Letter dated 20th August 1976

The Lakshmi Vilas Bank Ltd., a licensed scheduled commercial bank had, in June 1976, sought our permission for inclusion of its name in the list of approved banks, for the purpose of entering into participation arrangements, with the other approved financial institutions. The bank's request was, however, declined. In this connection, our office note dated 2nd August 1976 and the E.D.(L)'s remarks thereon may please be seen at flag 'K'.

2. The bank has again approached us with a request to reconsider the application. In this connection, it has stated that it is now diversifying the advances to industrial units to a sizable extent from that of traditional business of advancing amounts against pledge of gold and jewels. Further, in order to make rapid strides in the matter of diversification of advances, it is making endeavours to build up necessary infrastructure. This requires extension of its branch network at metropolitan centres like Bombay, Calcutta, Hyderabad, etc. In addition to this, it has stated that the industrial units which are enjoying facilities with it, pay large insurance premium to the general insurance companies. These associations could be distinctively advantageous to the bank provided it is permitted to enter into participation arrangements and thereby afford it an opportunity to augment its resources position. This would also facilitate it, in extending larger credit, inter alia, to the industrial sector. If the bank's request to enter in the participation arrangement is declined, it may suffer loss of interest. It also fears that it would not be in a position to compete effectively with the banks which are placed in the approved list and will face genuine hardship in strengthening its resources particularly when it is short of funds. The financial position of the bank is as under:

	(in lakhs)	
	1974	1975
1. Paid-up capital	20.11	22.87
2. Reserve fund	18.00	23.65
	(as on 6-8-76	13-8-76)
3. Deposits	2048.27	2083.07
4. Advances	1304.00	1318.00

Accordingly, there seems to be some force in the bank's above argument. It is a small-sized bank and it may not be possible for it to meet suitably the increasing demand of its borrowers from its own resources. In the circumstances, it is for consideration whether we may grant necessary permission to the bank to enter into participation arrangements with other approved institutions on the terms and conditions set out in our current circular letter dated 17th May 1976.

O (Gon)

31.08.1976

D (Apte)

31.08.1976

For the purpose of the Participation Certificates Scheme, we have, so far, approved thirteen banks in the private sector. The smallest among these is the Karur Vysya Bank Ltd. other than Bharat Overseas Bank whose deposits stand around Rs 27 crores at the end of August 1976. Even compared to these banks, the operations of the Lakshmi Vilas Bank Ltd. are smaller. When we consider the request of the Lakshmi Vilas Bank Ltd., we may have to consider whether it is necessary for us to stipulate some minimum limit, say Rs 25 crores' deposits . . . it may not be advisable for smaller banks to enter into the business of Participation Certificates with a view to granting advances to industrial concerns. It is important to note that once an advance is granted even on a cash credit basis, it is generally anticipated that it will continue to be allowed, and it is really difficult to withdraw the funds from a going concern. In the above context, it is in the interests of the Lakshmi Vilas Bank Ltd., to increase its deposits, to expand its business and earn more profits. Apparently, the bank is keen to make quick profits by accepting monies from insurance companies, when available. One point which is favourable to the bank, however, is that another bank in Karur itself, viz., Karur Vysya Bank Ltd. has been approved by us for the purpose. On this score, the Karur Vysya Bank Ltd. is favourably positioned, while the Lakshmi Vilas Bank Ltd. is at a disadvantage, although both are licensed scheduled banks. But we have to fix some minimum requirements for approving a bank under the Participation Certificates Scheme and it is desirable that we reject the request of the Lakshmi Vilas Bank Ltd. for reconsideration.

01.09.1976

The bank is faced with the problem of augmenting its resources in order to meet the emerging demands consequent to diversification of its advances portfolio. There is, therefore, some force in the bank's argument and its request for being included in the approved list of banks for the participation certificate scheme merits examination de novo.

As the issue relates to the question of adequacy or otherwise of the bank's resources and their uses, Credit Planning Cell may please throw more light on it.

02.09.1976

Adviser (Shri Raman)

A note recorded by Dco (B) is attached.

06.09.1976

Addl.Co. DBOD

E.D.(L)

The Participation Certificate Scheme has not always been used with sufficient care by the smaller banks, with the result that they are able to get into a resource jam.

On balance, we may say no to Lakshmi Vilas Bank and also . . . the Karur Vysya Bank should remain in the list.

PARTICIPATION CERTIFICATES SCHEME
LAKSHMI VILAS BANK LIMITED

As regards suggestion made by D.G. (K) on pre-payers, regarding reviewing the case of Karur Vysya Bank Ltd., . . . to remain in the list of approved banks for the purpose of entering into Participation Certificates Scheme. We may examine it separately.

Draft reply to Lakshmi Vilas Bank Ltd., may please be approved.

O (Gons)
22.09.1976
D (Haj)
22.09.1976

NOTE: Fair Letter to the Chairman, Lakshmi Vilas Bank Ltd. is placed below for signature please.

CREDIT PLANNING CELL
PARTICIPATION CERTIFICATES SCHEME
LAKSHMI VILAS LTD., MADRAS

Kindly see the note from DBOD placed below.

2. The question of granting permission to a bank for inclusion in the list of approved banks for the purpose of entering into participation arrangements with other approved, financial institutions has to be viewed in the wider context of enabling the bank to mobilize the surplus resources within the financial system and the scope for utilizing these for productive purposes. This, in fact, is the basic objective of the Participation Scheme.

3. Lakshmi Vilas Bank has stated that it is in a position to mobilize surplus resources from the General Insurance companies and employ these resources for diversification of its advances particularly to industrial units. It is observed that the Karur Vysya Bank was granted permission to enter into participation arrangements precisely on these considerations. It would, therefore, be difficult for us to deny similar facilities to Lakshmi Vilas Bank. The size of the bank in terms of its deposits need not be a very material factor in taking a decision on this issue, provided the affairs of the bank are being conducted in a satisfactory manner.

In view of what is stated above, Lakshmi Vilas Bank may be granted permission to enter into participation arrangements with other approved financial institutions, subject to the usual conditions.

D.G. BORKAR
6/9/1976

I agree with DCO(B).
Addl. Co. DBOD

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BANKERS' COMMITTEE FOR EACH STATE—20-POINT ECONOMIC PROGRAMME

Please see the news item appeared in *The Economic Times* dated 29th October 1976 on the above subject. The Union Ministry of Revenue & Banking is stated to have allotted the task of coordinating efforts for implementation of schemes prepared under 20-Point Economic Programme in the states to nine public sector banks as shown below:

Name of the bank	Names of States of which it will hold charge
1) State Bank of India	1) Andhra Pradesh 2) Jammu & Kashmir 3) Meghalaya 4) Nagaland 5) Orissa
2) Central Bank of India	1) Bihar 2) Madhya Pradesh
3) Bank of Maharashtra	1) Maharashtra
4) Bank of Baroda	1) Gujarat 2) Rajasthan 3) Uttar Pradesh
5) United Bank of India	1) Assam 2) Manipur 3) Tripura 4) West Bengal
6) Punjab National Bank	1) Haryana 2) Himachal Pradesh 3) Punjab
7) Canara Bank	1) Kerala
8) Indian Overseas Bank	1) Tamil Nadu
9) Syndicate Bank	1) Karnataka

The functions of the Committee are stated to be: (i) to consider problems requiring inter-bank coordination such as area demarcation for implementation of different schemes, (ii) allocation of schemes being implemented at the district level, and (iii) bringing uniformity in the terms and conditions of credit under specific schemes.

The participants in the Committee will include, besides the banks concerned, Chairman of regional rural banks, representatives of commercial banks, Government agencies, representatives of state cooperative banks and land development bank. The Chief Minister have also been requested to associate representatives of the Central and State legislatures with the Committee.

2. We have neither been consulted in the matter nor a copy of the instructions

issued by Government has been received by us. In this connection, our D.O. letter dated 13th July 1976 to Government may please be seen. The basis on which the allotments of states have been made are not known to us. It is proposed to write to Government as in the draft letter placed below for approval please.

4.11.76

SETTING UP OF STATE-LEVEL BANKERS' COMMITTEES

As desired by D.G. (K), the C.O. had written to Shri Menon for the details of instructions issued in the matter by Government to banks. A copy of the instructions issued by Government to banks has since been received and is placed below. The functions of the Committee and the responsibility of convening the meetings of the Committee in each State are as indicated on pages 1 & 2 of the note. The basis of allocation of States to banks are their lead responsibility and also the spread of their branch network in rural areas. The meetings of the Committee are expected to be held at least once in a quarter. It has also been suggested that these meetings should be held before each meeting of the State Level Coordination Committees which are being strengthened by State Governments through association of the members of Parliament and State legislatures.

It is not known whether a representative of the Reserve Bank of India would be associated with the Bankers' Committee. As regards State Level Coordination Committee, we had recently received a request from the Government of West Bengal for nomination of RBI's representative on such a Committee and we have nominated our Joint Chief Officer, Calcutta on the Committee.

24.11.76

D (Krishnan) It would appear that on receipt of C.O.'s D.O. letter to Shri Menon, the Government have merely endorsed a copy of circular addressed by them to SBI and the 14 Nationalized banks and 31 grameen banks. Detailed instructions from Government to us on the subject will help us to activate our regional offices, which, in turn, will have greater involvement so as to hasten the process of implementation of the 20 Point Economic Programme by the commercial banks.

C.O.

25.11.76

Governor may like to see their office notes as also the circular issued by the Dept. of Banking. This is yet another instance of by-party of the RBI by the Dept. Governor had told me sometime back that he had suggested to HRD a clear demarcation of the functions of the RBI to the Dept. Would it be convenient for the Governor to take up this matter in his next visit to Delhi?

25.11.76

Governor

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Kum. Kusum Lata Mital
Joint Secretary

MINISTRY OF FINANCE
DEPARTMENT OF ECONOMIC AFFAIRS
(BANKING DIVISION)
'JEEVAN DEEP' PARLIAMENT STREET
NEW DELHI

D.O. No. 8(17)/77-CPT

30th December 1978

Dear Shri Singh,

It will be recalled that your bank had suo moto requested for being allowed to operate the Differential Rate of Interest Scheme in your lead districts. We understand from the Reserve Bank of India that all the private sector banks which were entrusted with lead responsibility and were implementing the Differential Rate of Interest Scheme have not been filing quarterly returns. Consequently, the progress of implementation by your bank cannot be monitored.

2. It will be recalled that at the meeting convened by the Prime Minister with the Chief Executives of banks and term lending institutions in October 1978, both the Prime Minister and the Finance Minister had laid considerable stress on the private sector banks falling in line with the working patterns of the public sector banks so as to achieve the social obligations expected from the banking system. This issue has also been stressed by the Governor, Reserve Bank of India in his recent address to all banks. Some private banks have also agreed to implement the DBI Scheme in its enlarged form.

3. It is regretted that upto now the performance of your bank under the DRI Scheme has been very unsatisfactory.

4. In view of the importance now being attached by the Government for providing credit at concessional terms to the weaker sections of the community, you are requested to chalk out a time-bound programme for enlarging the lending by your bank under the DRI Scheme so as to achieve the minimum stipulation envisaged therein.

5. A copy of this letter is being endorsed to the Reserve Bank. You are requested to keep this Department advised regarding the progress in this direction.

Yours sincerely,
KUM. KUSUM LATA MITAL

Shri Inderjit Singh
Chairman
Punjab & Sind Bank Ltd
H-Block, Connaught Circus
New Delhi

Copy to the Chief Officer, DBOD, Reserve Bank of India.

N.B. Government issued similar letters to the Chairman of Andhra Bank Ltd. and Bank of Rajasthan Ltd.

Y.P. SETHI

UNDER SECRETARY TO THE GOVT. OF INDIA

Remarks recorded by the D.G.(K) and C.O. have been circulated among B.P. and B.L. sections. Only for information, no action necessarily appears.

ACO (H)

02.02.1979

DCO (R)

02.02.1979

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V.K. Dikshit
Joint Secretary

MINISTRY OF FINANCE
DEPARTMENT OF ECONOMIC AFFAIRS
(BANKING DIVISION)
'JEEVAN DEEP'
PARLIAMENT STREET
NEW DELHI - 1
3.3.81

D.O. No.8(26)/77-CPT

Dear Shri Tambe,

One of the recommendations of Dr K.S. Krishnaswamy Working Group as contained in para 3.7 of the report which has been accepted by the Government, deals with assistance through intermediary organizations. This recommendation covers all advances to priority sector and 20-point programme and would seem to apply to advances under the Differential Rate of Interest Scheme as well.

2. We have been approached by some State Governments and State Sponsored Corporations with requests that they should be recognized as approved intermediaries for channelizing credit under Differential Rate of Interest to Scheduled Castes, Scheduled Tribes and other weaker sections of society. We have, so far, not agreed to such requests. However, in the light of the above referred recommendations of the Working Group headed by Dr Krishnaswamy, such requests have to be examined afresh.

3. I shall, therefore, be grateful to be apprised of your reaction to the requests for routing of the Differential Rate of Interest credit through State sponsored

corporations. As you are aware, at present, the Differential Rate of Interest credit is being routed only through State Corporations for the welfare of SCs/STs and the Cooperatives/LAMPS in identified tribal areas.

With regards,

Yours sincerely,
V.K. DIKSHIT

Shri W.S. Tambe
Executive Director
Reserve Bank of India
Central Office
Bombay

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Joint Chief Officer

9th May 1981

B.P. 377/C. 453(a)-81

Dear Shri Dikshit,

DRI ADVANCES THROUGH STATE SPONSORED CORPORATIONS

Please refer to your D.O. letter No. 8(26)/77-CPT dated 3rd March 1981 addressed to Shri W.S. Tambe, our Executive Director. The Working Group on Priority Sector Lending and the 20-Point Economic Programme has, inter alia, recommended that banks, while continuing to provide direct assistance, may also route credit to individual beneficiaries through State sponsored corporations/agencies besides functional cooperatives. On the basis of the recommendations of the Working Group, we have advised the State Governments that they may set up corporations/agencies exclusively for the benefit of weaker sections so that the banks may also route credit to individual beneficiaries through them.

2. Government have permitted banks since May 1977 to route advances under the DRI Scheme through State Corporations for the welfare of scheduled castes and scheduled tribes. Banks have also been permitted by Government since December 1978, to route credit under the Scheme through RRBs on an agency basis and cooperative societies/LAMPS organized specifically for the benefit of the tribal population in areas identified by the Government. Further, Government have recently permitted the sponsoring banks to lend under the Scheme through RRBs on a refinance basis.

3. One of the main reasons which weighed with the Working Group on 20-Point Programme in suggesting assistance through intermediaries is that it may not be possible for commercial banks to directly cater to the credit requirements of a large number of beneficiaries. Banks' advances to priority sector at the end of December 1979 under 110 lakhs borrowal accounts aggregated Rs 6011.47 crores constituting around 34 per cent of the total advances. Banks have to ensure that this proportion goes up to 40 per cent by 1985. It is expected that by 1985 the

volume of priority sector advances would be more than double the present level while the number of beneficiaries would be about three times the present number. However, under the DRI Scheme banks have to lend a minimum of 1 per cent of their aggregate advances. The advances granted under the Scheme at the end of March 1980 under 22 lakhs borrowal accounts amounted to Rs 150 crores constituting 0.9 per cent of the total advances of the banks. Banks have thus almost reached the target and the additional funds that will be available for lending under the Scheme are limited. Besides, the RRBs which operate mainly in rural areas have also been recently permitted to lend under the Scheme on a refinance basis. We, therefore, believe that no useful purpose may be served by allowing State sponsored corporations as intermediaries to lend under the Scheme. Permission to lend under the DRI Scheme through them may also bring about anomaly in the interest rate charged to the borrowers as the corporations are also expected to finance under other schemes at normal rate of interest.

With kind regards,

Yours sincerely,
M.L. INASU

Shri V.K. Dikshit
Joint Secretary
Ministry of Finance
Deptt. of Economic Affairs
(Banking Division)
'Jeevan Deep'
Parliament Street
New Delhi – 110 001.

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Managing Director

STATE BANK OF INDIA
CENTRAL OFFICE
BOMBAY, No. 1
4th January 1969
No. OP-285

Dear Shri Adarkar,

PROPOSED ASIAN—AMERICAN BANK

Our New York representative has written to say that the Bangkok Bank Limited are interested in setting up an Asian—American bank as a joint venture of five banks operating in south-east Asia. The *raison d'être* for such a venture has been stated to be the absence of branches of Asian banks in New York except Japan, Pakistan and the Philippines, and the proposal proceeds on the footing that as it may not be profitable for a south-east Asian bank to open a branch all on its own, a joint venture would be the answer. The idea is still in a preliminary stage, but we have been sounded whether we would like to participate along with four other banks—

Bank of New South Wales, Australia

Overseas Union Bank Limited, Singapore
 Prudential Trust, Manila, and
 Bangkok Bank Limited, Thailand

2. Brief details of the proposal are as follows:-

- (a) Share capital of US \$20 million presumably to be contributed equally.
- (b) The scheme envisages that Governments of each participating bank would designate the Asian-American Bank Limited as one of their depository banks for the placement of foreign exchange funds; the bank will also handle official transactions along with the other agencies of the Governments concerned. Besides this, it is envisaged that each Government would leave a permanent deposit of US \$10 million on which interest would be paid.
- (c) The proposed bank would be the main New York correspondent of the participating banks.
- (d) The bank will offer complete trade financing facilities, including letters of credit, discounts, acceptances, foreign exchange facilities, etc., and it is hoped that, with the wide network of offices of the participants, the new bank should be able to cash in on their knowledge of customers, regulations, legal requirements, etc. and thereby have an edge over American banks doing business with the participant countries.
- (e) Total funds employed have been assumed at US \$60 million (presumably after meeting start-up expenses, liquidity requirements, etc.) and an initial gross profit of US \$11,28,000 has been estimated.

3. We have given consideration to the proposal on the basis of the brief data supplied. While several questions require answer, our preliminary reaction is that it would be difficult and that it may not be worthwhile for us to participate. Firstly, there is the question of a sizeable capital contribution (US \$4 million; Rs 3 crores) from us. The surplus resources of our London office are not sufficient for a diversion of this order, and we would necessarily have to arrange for a remittance from India which the Reserve Bank of India, in line with their present policy, would not allow. Secondly, we are not too sure whether the Government of India would be agreeable to lodge a sizeable deposit of US \$10 million (Rs 7.5 crores) with the proposed bank at an interest of 6 per cent per annum on a permanent basis. The third question is what the proposed bank is expected to achieve. With working funds of US \$60 million (prospects of US nationals placing deposits may be discounted), the bank can finance the large transactions we have with USA only to a marginal extent; besides ourselves, there would be four other countries involved. We have, at present, a wide network of correspondents in the USA operating as an efficient machinery for routing transactions between the USA and India. The proposed bank cannot be a substitute for this, besides which the impact of our participation on our correspondents, with whom our relations are cordial precisely because we do not compete in the USA, would possibly be unfavourable. Lastly, by participating in

the venture, we will be ruling out our ever-opening a full-fledged office if circumstances should become propitious.

4. All told, our preliminary reaction is unfavourable. A representative of the Bank of Bangkok may possibly visit India in the near future to sound us, and I thought it would be useful if I apprised you of the proposal and had the benefit of the views of the Reserve Bank of India. I am sending a copy of this letter to Ghosh of the Finance Ministry with a request to let me know Government's reaction.

Yours sincerely,
N. RAMANAND RAO

Shri B.N. Adarkar
Deputy Governor
Reserve Bank of India
Central Office
Bombay – 1

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D.O.No.DBOD, B.L.471/C, 212–69

February 7, 1969

Dear Shri Ramanand Rao,

PROPOSED ASIAN–AMERICAN BANK

Please refer to your D.O. letter No. O.P. 285 dated 4th January 1969 on the above subject. We generally agree with your approach to the proposal as set out in paragraphs 3 and 4 of your letter. We, however, consider that as a long-term policy, it is desirable that an Indian bank should open a branch in the United States. We shall be glad to have the State Bank's views on this suggestion in due course.

Yours sincerely,
B.N. ADARKAR

Shri N. Ramanand Rao
Managing Director
State Bank of India
Central Office
Bombay – 1

DBOD. No. B.L. 472/C. 212–69 dated 7th February 1969

Copy forwarded to Shri D.N. Ghosh, Deputy Secretary to the Government of India, Ministry of Finance, Department of Economic Affairs, New Delhi, with reference to his D.O. letter No. F.8/2/21/69-SB dated 30th January 1969 to Shri Nadkarni.

CHIEF OFFICER
BANKING OPERATIONS

C 212/Vol. 9

April 1969

INTERNAL NOTE

I do not think that it will be possible either for Government or for the Reserve Bank to deposit a sum of US \$10 millions or, for that matter, any other sum with the proposed Asian–American Bank in New York.

2. The rate on negotiable certificates of deposits, which is what we are offered, is lower than that on commercial paper and banker's acceptances and the rates quoted by the B.I.S., which are fractionally higher than even these rates. The extra yield on deposits with the new bank, as compared with the yield on treasury bills, is also so marginal that it can be ignored.

3. This, however, is a minor point. It will not be appropriate for the Reserve Bank to open an account with a private bank, especially when it has no international standing. Although there is no legal obstacle, we cannot recognize and entrust our funds to a new institution like this, when in spite of the higher yields which could have been obtained, we have not been anxious to divert our funds to any of the leading American banks in the past.

4. As far as Government is concerned, on the advice of the First Boston Corporation, who are the fiscal agents for the Government of India in the United States, they keep their I.S.M. balances with about fourteen leading commercial banks in the United States. The criterion on which these banks have been chosen is the extent of their direct or indirect investments in India, in the form of loans to enterprises in which the Government of India is interested or participation by the banks in the I.B.R.D. issues for financing loans to India. The banks with which deposits are now held are able to provide letter of credit and other facilities to the Government of India, on terms which the new institution will obviously not be able to command. The Government of India cannot also depart from its criteria. Although the Ambassador (Economic) and Financial Adviser of our Embassy in Washington are authorized to approve of ad hoc additions to the list of local bankers for the I.S.M., they cannot ignore liquidity and safety, which they are required to take into account under the memorandum of instructions drawn up and issued in February 1963.

5. In view of the above, the State Bank's preliminary view, namely, that this proposal cannot be pursued further appears to be justified and may be supported.

R.K. SESHADRI

25.4.1969

(D.G. (A) I think we should advise Shri Ramanand Rao that it would be possible to take a view about the disability of placing a deposit of US \$ 10 million with the new bank in a permanent basis only after the State Bank of India has assessed the merits of the proposition. As ED(S) has observed in para 3 above, there is no difficulty in law in RBI making the deposit; if so, the other considerations mentioned by ED(S) have to be weighed against the advantages, if any, which SBI may find in the scheme.)

28.04.1969

I agree with D.G. (A) that it is necessary for the State Bank to make an assessment as an institution of the advantages that it may derive from participating in the proposed scheme. At the same time, sooner or later, a view on a wider plane will also have to be taken by the Reserve Bank and Government. I see some advantages in bringing the Government into the picture even while the SBI is examining the scheme strictly on merits.

I recall that at one time both the Economic Secretary and myself had felt that it might be worthwhile for the State Bank to have a branch in New York not so much on the consideration of what the SBI could earn but on wider considerations. On the one hand, there would be the point about reciprocity: if American banks have branches here, our leading bank should also have a branch in the USA. Then again, on many matters, the State Bank could be generally helpful to the Indian economy in the conduct of Government business as well as the country's export trade, if there was a branch in a place like New York. Shri Dehejia, however, was firmly of the view that a branch would be so much of a losing proposition that it would not be worth the State Bank's while to open a branch.

The present proposal has one more angle to it which is of interest to us and to the Government. We very often talk of regional cooperation. The support we have had in this is not too significant. There are trends to indicate that South-East Asian countries in some matters tend to leave India out of the picture. Thus, when South-East Asian Governors meet, Governors from India and Pakistan are not invited though the Governor from Nepal is. On the other hand, there is also a tendency that if India comes into the picture, Japan might also be roped in.

The present proposals have a different orientation. We are asked to join in the scheme; if we do not, there is the possibility of further widening of the gulf between India and a number of Asian countries.

I am not for a moment suggesting that these considerations tilt the scale very heavily in favour of the decision. On the contrary, the pros and cons would need to be weighed very carefully. I would suggest, therefore, that simultaneously with writing to Shri Ramanand Rao, D.G., might also address a letter to Dr Patel.

29.4.1969

D.G.(A)

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D.O.No. DBOD.B.L. 1620/C.212-69

April 29, 1969

My dear I.G.,

I enclose a copy of a letter received from Shri Ramanand Rao about the proposed Asian-American Bank. State Bank of India are examining the proposal, but have enquired, in the meanwhile, whether the Government of India or the Reserve Bank would be agreeable to place a deposit of US \$10 million with the proposed bank on a permanent basis. After consulting the Governor, we have advised Ramanand Rao that it would be possible to take a view on this matter only after the State Bank, as

an institution, has made an assessment of the advantages it may derive from participating in the proposed scheme.

2. You will recall that at one stage both the Governor and you had felt that it might be worthwhile for the State Bank to have a branch in New York, partly as a matter of reciprocity and partly for its possible benefits to the country's export trade. Shri Dehejia, however, was of the view that the branch in New York would be so much of a losing proposition that the matter was not worth pursuing.

3. The present proposal, however, has certain aspects which are of interest to the Government as well as the Reserve Bank. The Bangkok Bank has sponsored this proposal as a means of furthering regional cooperation and our participation in it may materially influence the attitude of countries like Japan. From our own standpoint also, the implications of our keeping out of a scheme of regional cooperation have to be borne in mind. The present proposals have thus a different orientation. We have been invited to join in the scheme; if we do not respond, there is some risk of widening the gulf between India and some of the South-East Asian countries.

4. While we would like the above considerations to be given due weight, we would not suggest that they tilt the scale very heavily in favour of the decision. On the contrary, the pros and cons need to be weighed very carefully. The Governor has, therefore, asked me to bring this matter to your personal attention while simultaneously requesting Ramanand Rao to examine the proposition from his own angle.

Yours sincerely,
B.N. ADARKAR

Dr I.G. Patel
Special Secretary
Ministry of Finance
Department of Economic Affairs
Government of India
New Delhi.

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D.O.No.F.15(20)-BO.III/72

MINISTRY OF FINANCE
DEPARTMENT OF BANKING
'JEEVAN DEEP' PARLIAMENT STREET
NEW DELHI
November 23, 1972

D.N. Ghosh
Jt. Secretary

Dear Dr Hazari,
Please refer to the correspondence resting with Shri Chakrapani's D.O. letter No. DBOD. B.D. 3015/C. 10 (A)-72 dated 15th June 1972, addressed to Shri Balasubramanian, regarding the opening of a representative office by the Bank of

India at Djakarta. In another similar case, we have received a D.O. letter No. DBOD. B.D. 4654/C. 353 (A)—72 dated 30th August 1972, from Shri Ambani, informing that the Reserve Bank have approved the proposal of the State Bank of India to open a branch at London—West End (United Kingdom).

2. The opening of a branch or a representative office by an Indian Bank in a foreign country has political overtones. Government will have to keep in view the mutual relations between India and the country concerned and also the future prospects. We would, therefore, suggest that whenever any application for any bank is received for opening a branch or a representative office in a foreign country, whether for the first time or not, a reference may be made to us; we would, in turn, consult the Ministry of External Affairs and Department of Economic Affairs and communicate the views of the government to the Reserve Bank. We would greatly appreciate if this is followed as a convention in future. This has the approval of the Finance Minister.

Yours sincerely,
D.N. GHOSH

Dr R.K. Hazari
Deputy Governor
Reserve Bank of India
Central Office
Bombay – 1

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OPENING OF OFFICES OF INDIAN BANKS IN FOREIGN COUNTRIES

Ref: Shri D.N. Ghosh's D.O. letter No. F 15(20) BO. III/72 dated 23rd November 1972 and the Governor's remarks therein.

1. *United Kingdom*

A statement showing the particulars of offices of Indian banks functioning in UK indicating therein the dates of their opening as also of the licences/allotments pending with banks for opening offices, is attached. So far as State Bank of India is concerned, the approval of its Executive Committee was obtained by the bank for its proposed office at London—West End at the meeting held on 30th August 1972 and the minutes of the meeting were subsequently placed before the bank's Board at the meeting held on 14th November 1972.

2. *Indonesia*

In August 1967, a reference was received from Government of India calling for our comments on the suggestion made by the then Indian Ambassador in Indonesia, to open an office of Indian bank in Djakarta. As the proposal involved remittance of funds to the extent of US \$1 million and as the State Bank of India, which was asked to examine the feasibility of opening an office in Indonesia by providing the requisite funds from its overseas branches, expressed its inability, Government of India was advised that it might not be worthwhile to pursue the matter.

Later during the discussion our Deputy Governor (Dr Hazari) had with Shri A.

Baksi, the then Secretary, Banking Department, in New Delhi on 14th February 1971 (when Shri V.M. Bhide and other officers of the Banking Department were also present) was given to understand that there was no objection from the Government's side to the Bank of India opening a branch in Djakarta.

Governor may like to see the note on pre-page. Re: The substantive point in Shri Ghosh's letter I would prefer that we have a discussion on the general future spread of Indian banks' branches abroad with External Affairs, Economic Affairs and Banking Deptt. rather than accept a procedure as suggested of consulting Government formally on each proposal. As Government would appreciate, the latter would be time consuming, ad hoc and in terms of perspective unsatisfactory.

DG (H)

7/12

Governor on return

11/12

Please see Governor's note dated the 29.12.72

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These papers below are of interest. Government, in the Department of Banking, have requested that we may consult them if there are any proposals for further opening of branches of Indian banks in foreign countries. It has been stated that in appropriate cases, the Ministry of External Affairs would have to be consulted.

D.G. (H) and I agreed that it would be best to have such discussions in advance, in principle, regarding the countries in which it would be advantageous to have the opening of further branches.

I had discussions with Shri N.C. Sen Gupta on this basis. I believe I mentioned to him our ideas that it would be advantageous to have branches opened: (1) in Germany, with whom we have such a volume of trade and (2) in France (having regard to the fact that the French have a bank in India and could be expected to reciprocate). In addition to the branches that we expect to open in West Asia (including the 'Gulf'), it would be perhaps advantageous to have one further bank (State Bank) to open a branch in Tokyo and that it would be highly desirable to have a branch or branches opened in Indonesia as soon as we are permitted. The existing branch in Thailand will have to be reconstructed. The question of opening branches in Africa will have to be separately considered. (I wonder if D.G. (H) would care to give me a draft letter or write himself to Secretary, Banking covering the above ideas with such modification or expansion as may be called for.)

S. JAGANNATHAN

29.12.1972

D.G. (H)

02.01.1973

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Summary record of the discussions at the Deputy Governor's (Dr R.K. Hazari) meeting with the Chairman of certain selected commercial banks held at the Reserve Bank of India at 4 p.m. on 18th April 1974 regarding opening of offices in foreign countries.

The question of opening branches by Indian banks abroad in the context of growing international trade emanating from India and other relevant factors has been engaging the attention of the Reserve Bank of India for some time. So far, individual banks have been opening offices abroad after making their own individual assessment of business potential at various centres. Recently, the need was felt for making a concerted effort to determine the needs and priorities and explore the possibilities of rapid expansion of Indian banks in foreign countries in a planned and coordinated manner so as to derive the optimum benefit for the country from such expansion. As a first step in this direction, a meeting of the Chairman of certain selected commercial banks was convened by the Reserve Bank of India on 18th April 1974, for the purpose of considering the various issues involved in the functioning as well as opening of new offices in foreign countries. Deputy Governor, Dr R.K. Hazari, presided over the meeting. The names of the representatives who participated in the meeting are furnished in Annexure I.

2. At the outset, the Deputy Governor stressed the urgent need for expansion of Indian commercial banks in foreign countries and invited the bankers to set out the various handicaps and constraints they were experiencing or were likely to experience in opening offices, the types of business that could be handled by them as also the areas which could be profitably covered within a period of next two to three years. He explained that the main objectives of expansion of Indian banks abroad should be the earning of foreign exchange and expansion of their sphere of activities and influence so as to prove to be a catalyst for growth of Indian trade and business. They could also play a crucial role in helping to promote and setting up of joint ventures and financing investment of Indian industries which are operating either singly or jointly with foreign industrial concerns in foreign countries. The representative of the Government of India (Shri D.N. Ghosh) explained that Government expected banks to go in a big way in some of the foreign countries, particularly the West Asian region, and assured the bankers of full support in their efforts in this regard from the Government. Thereafter, there was a detailed discussion on the various issues raised by the bankers. The points that emerged out of the discussions are enumerated below:-

- (i) Some of the bankers expressed that the present restriction while permitting banks to open offices outside India, that no overdraft arrangements would be allowed from Head Office, needed modification. According to them, since the volume of business at the overseas branches was increasing considerably, these offices did experience difficulty, at times, in finding resources for financing of their business out of lines of credit obtained from foreign banks, and therefore standby country-wise/centre-wise arrangements from the Head Office would be necessary. It was agreed that the feasibility of the above

proposal would be considered by the Exchange Control Department of the Reserve Bank.

- (ii) In countries where the laws of the Government are not in favour of foreign banks opening branches or where business considerations so required, it may be necessary to register the presence of Indian banks by capital participation either with local banks or with other foreign banks already operating there. This would entail clearance of the principal of financial participation and remittance of funds. The extent to which such remittance would be allowed by Government would have to be made clear, if any dialogue had to be started by the concerned banks for such joint participation. In cases where full-fledged branches are to be established, apart from remittances towards capital for meeting statutory requirements, it would be necessary to remit funds towards initial expenses for setting up of the branch as also for meeting the working capital needs till such time as the branch becomes viable, which may extend to say a period of three to five years. It would be helpful if Government could lay down broad guidelines in this regard.
- (iii) It was also represented that there should not be any objection to Indian banks' branches abroad dealing with nationals of other countries, irrespective of our relationship with those countries.
- (iv) By virtue of the powers vested in it, the Enforcement Directorate calls for information in respect of banks' constituents abroad also. Apart from the fact that it is not clear whether the banks would get protection against any action taken by the parties concerned, particularly when such protection is not available under the laws of the relative countries, this has the effect, to some extent, of inhibiting the growth of business of Indian offices abroad. It was mentioned that while it was not the intention of banks to shield parties who might be guilty of violation of law, it would be necessary for the Government to amend the law in such a way as to ensure that it did not inhibit growth of business.

It was agreed that the issues raised in items (ii), (iii) and (iv) above would be examined by the Government.

3. It was represented that, at present, there was no incentive for non-residents to keep their funds with banks in India in the form of either foreign exchange or Indian rupees, and that apart from the fact that a number of formalities had to be gone through for repatriation of such funds, there was likelihood of an adverse effect on the investment itself on account of variations in the rates of exchange at the time of repatriation. The bankers, therefore, stressed the need for permitting banks to maintain foreign currency accounts in India. It was mentioned that if such permission were granted, the parties would be protected from any loss on account of fluctuations in rates of exchange and the country would have substantial

foreign exchange which could be used for its benefit. Banks assured that the utilization of such funds in India would be only for such projects as were approved by the Government. It was also represented that the Exchange Control Department should be less restrictive in so far as maintenance of foreign currency position is concerned, and that they should be permitted to maintain suitably longer positions. It was decided that the Exchange Control Department of the Reserve Bank of India should examine the above issues in detail.

4. Thereafter, the discussions centred around allocations among banks. The countries/centres considered for opening of offices are listed in Annexure II. Deputy Governor indicated that, while selecting centres for opening offices abroad, due considerations should be given to the magnitude of the existing as well as potential trade of the country in general, and with India in particular, the interest of the population of Indian origin that is likely to be served, the commercial viability of the proposal in relation to the environment of international money markets and the remittances that will be involved on account of capital and working expenses. He mentioned that it would be necessary to fix priorities while selecting countries/centres for opening offices, having regard to the present magnitude of trade and payment transactions, financing of investment of Indian industries which are operating either on their own or jointly with foreign industrial concerns in foreign countries, and the need to build up an efficient structural base in the world's financial centres for operations in the international money markets and multi-currency transactions. In this context, it was considered necessary to give priority to opening offices in the West Asian region. This region is in a buoyant state of economic and financial growth with large foreign currency surpluses on account of hike in oil prices. The countries in the region have ambitious plans for development and there is a high potential absorbing capital goods, consumer goods and technical know-how. Against this background, Indian banks have an important role to play in not only furthering India's exports to these countries but also in developing closer economic relations with them. It should also be possible for Indian banks to employ the surplus resources available at these centres gainfully through their other offices abroad. Priority may also have to be given for opening offices in the international financial centres which will enable the banks to operate in the financial markets, and will also serve as a reservoir of funds for its other branches. It was also made clear that reciprocity had been accepted by Government of India in principle and that banks would have to be guided not only by profitability but also by the broader aspect of the prospects of generating trade, setting up of industries, etc. Having regard to the above factors, it was decided that UK, particularly London, should be kept open for entry by Indian banks, each application being decided on merits. Tentative decisions taken in regard to allotment of other countries or centres are given below:-

Name of country (1)	Name of centre (2)	Name of allottee bank (3)	Remarks (4)
1. USA	San Francisco	Bank of India	1. The bank's request for a possible extension at Los Angeles will be sympathetically considered. 2. The claims of other banks for centres in USA will be kept in mind. To try for a Representative Office.
2. Canada	Toronto/ Vancouver	State Bank of India	
3. Panama	Panama	Bank of Baroda	The bank will conduct a survey of the area.
4. Jamaica	—	Syndicate Bank	The proposal should be given low priority and a survey should be conducted by the bank for prospecting for a future date.
5. Suriname	Paramaribo	Bank of Baroda	—
6. UK	London	Syndicate Bank Punjab National Bank	Being their first entry abroad, it would be advantageous for them to establish offices first in London.
	Channel Islands	Bank of India	The bank has proposed to consider opening office in the place after sufficient potential has developed.
7. Netherlands Luxembourg Belgium	Amsterdam Luxembourg Brussels/ Antwerp	Bank of Baroda	As the bank was not sure at which of these places it would be in a position to obtain permission of the authorities of the countries concerned, it was decided to give the bank time up to six months to finalize the position and approach Reserve Bank in the matter. The question of allotting the remaining centres to any other bank/s will be considered thereafter.
8. Italy	Milan	Punjab National Bank	The bank has to conduct a survey to assess the potentialities.
9. USSR	Moscow	State Bank of India	The bank will consider the feasibility of shifting one of its existing Representative Offices at Frankfurt to Moscow.
10. Countries in West Africa	—	—	Bank of India has been asked to scout the region to ascertain the potentialities.
11. Lebanon	Beirut	State Bank of India	The bank has been asked to explore the possibility of establishing a full-fledged office in the form of joint participation subsidiary, etc.

12. Iran	Tehran	—	State Bank's report to be studied. Action will be taken shortly.
13. Kuwait	Kuwait	Bank of India	The bank will have to conduct a survey and explore the possibility of registering its presence in the country. The bank will also consider the prospects of having exclusively merchant banking in the area.
14. Bahrein	Manama	-do-	-do-
15. Oman	Muscat	Bank of Baroda	The bank has been given time for six months to obtain clearance of the authorities of the country so as to establish an office at the centre pursuant to the licence already granted to it. The interest of State Bank of India in opening an office at the centre will be kept in view.
16. Qatar	Doha	Bank of Baroda	The bank has also suggested another centre in the Persian Gulf area viz., Sarjan and it will be carrying out necessary survey for the purpose.
17. Bangladesh	Dacca	State Bank of India	—
18. Indonesia	Djakarta	Bank of India	The bank will explore the possibility of establishing a local bank with equity participation. Other Indian banks who may be interested will also be considered for participation.
19. Philippines	Manila	State Bank of India	The bank will prospect the area to consider the feasibility of establishing an office. Any other Indian bank operating in the region may be associated in the proposal.
20. Australia	Sydney	Bank of Baroda	The bank will explore the region for considering the feasibility of opening an office at the centre.
21. Laos	Vientiane	Bharat Overseas Bank Ltd.	The prospects of opening an office at the centre may be considered at a later stage.
22. Papua & New Guinea	Pt. Moresby	Bank of India	The feasibility of opening an office at the centre will be considered at a later stage.

It was decided that the question of considering the remaining countries/centres shown in Annexure II may be deferred for the present.

Finally, the Deputy Governor impressed upon the bankers the need to take early

measures for establishing/exploring the possibilities of opening offices in the countries/centres allotted to them.

He also stressed the importance of the role that our foreign branches have to play in the promotion of exports from India and exhorted the banks to make out all efforts in this direction. He suggested that among other things, banks may consider while extending credit facilities at their foreign branches the feasibility of linking credit to imports from and exports to India.

ANNEXURE I

Names of persons who participated in the meeting held on 18th April 1974 in connection with opening of offices abroad by Indian banks and presided over by Deputy Governor (Dr R.K. Hazari).

Reserve Bank of India

- | | |
|-------------------------|---|
| 1. Dr K.S. Krishnaswamy | Executive Director |
| 2. Shri M.L. Gogtay | Chief Officer, Department of Banking Operations and Development |
| 3. Shri C.L. Thareja | Controller, Exchange Control Department. |
| 4. Shri P.N. Khanna | Joint Chief Officer, Department of Banking Operations and Development |
| 5. Shri A.K. Bhuchar | Joint Chief Officer, Department of Banking Operations and Development |
| 6. Kum. N. Ambegaokar | Director, Division of Trade, Economic Department |
| 7. Shri S.H. Khan | Manager, Exports, Industrial Development Bank of India |

Government of India

- | | |
|--------------------|--|
| 1. Shri D.N. Ghosh | Joint Secretary, Department of Banking |
|--------------------|--|

Banks

- | | |
|-----------------------------|---|
| 1. Shri R.K. Talwar | Chairman, State Bank of India |
| 2. Shri P.L. Tandon | Chairman, Punjab National Bank |
| 3. Shri J.N. Saxena | Chairman, Bank of India |
| 4. Shri V.D. Thakkar | Chairman, Bank of Baroda |
| 5. Shri V.R. Desai | Chairman, United Commercial Bank |
| 6. Shri A.M. Kadhiresan | Chairman, Indian Overseas Bank |
| 7. Shri G. Lakshminarayanan | Chairman, Indian Bank |
| 8. Shri P.V. Seshagiri | Chairman, Bharat Overseas Bank Ltd |
| 9. Shri Miles Francis | Manager, Foreign Exchange, Syndicate Bank |

ANNEXURE II

Countries/Centres suggested for consideration at the meeting for opening offices of Indian banks.

Region	Country	Centre
A. <i>North America</i>	1. USA	i) New York ii) San Francisco iii) Chicago iv) Los Angeles v) Miami
	2. Canada	Toronto/Vancouver
B. <i>Central American Countries</i>	1. Panama	Panama
	2. Trinidad & Tobago	Port of Spain
	3. Jamaica	—
C. <i>South America</i>	1. Brazil	Rio de Janeiro/São Paulo
	2. Argentina	Buenos Aires
	3. Guyana	—
	4. Venezuela	—
	5. Surinam	Paramaribo
D. <i>UK</i>	1. UK	London and other places
	2. Channel Islands	—
E. <i>Western Europe</i>	1. France	Paris
	2. West Germany	i) Frankfurt ii) Hamburg
		3. Netherlands
	4. Italy	Milan
	5. Luxembourg	Luxembourg
	6. Belgium	i) Brussels ii) Antwerp
		7. Switzerland
F. <i>East European Countries</i>	1. Austria	Vienna
	2. Czechoslovakia	Prague
	3. USSR	Moscow
G. <i>Africa, etc.</i>	1. Nigeria	Lagos
	2. Ghana	Accra
	3. Sudan	Khartoum
	4. Ethiopia	Adis Ababa
	5. Zambia	—
	6. Gambia	Bathurst
	7. Sierra/Leone	Free Town
	8. Liberia	Monrovia
	9. Canary Islands	Las Palmas/Tenerife
	10. Mauritius	Port Louis
H. <i>West Asia</i>	1. Lebanon	Beirut
	2. Kuwait	Kuwait
	3. South Yemen	Aden
	4. Yemen Arab Republic	—

	5. Abu Dhabi	Abu Dhabi
	6. Oman	Muscat
	7. Bahrain	—
	8. Saudi Arabia	Riyadh
	9. Iran	Tehran
	10. Iraq	Baghdad
	11. Afghanistan	Kabul
	12. Qatar	Doha
I. <i>East and Far East</i>	1. Bangladesh	i) Dacca ii) Chittagong
	2. Indonesia	Djakarta
	3. Philippines	Manila
	4. Hongkong	Hongkong
	5. Japan	i) Tokyo
		ii) Nagasaki
		iii) Osaka
		iv) Kobe
	6. Australia	Sydney
	7. Singapore	Singapore
	8. Fiji Islands	Raki Raki
	9. Papua and New Guinea	Pt. Moresby

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D.O.No. DGH/2–360

May 17, 1974

Dear Shri Sen Gupta,

Thank you for your D.O. letter No. 25(5)/73-BO. III dated 13 May 1974. I note that you are convening a meeting at 11 a.m. on May 25 to discuss the question of opening of offices of Indian commercial banks abroad. I am requesting Shri A.K. Bhuchar to make it convenient to attend the meeting on behalf of Department of Banking Operations and Development. Shri Shiralkar is writing to you separately.

2. I do think that on balance it would be worthwhile from the country's point of view to allow banks which do not have branches abroad just now to open such branches and for this purpose to carry out surveys, where necessary, for the following reasons:

- (i) Unless a bank undertakes such activity it is never likely to have the necessary competence.
- (ii) A branch in UK, particularly in London, is a necessary first step towards entry in the field of international finance.
- (iii) Getting of a licence or its equivalent from a foreign monetary authority depends not so much upon a bank having or not having a foreign branch already, but upon its credit standing, size and management.
- (iv) Each bank has a certain ethnic image and I am sure you would agree that

Punjab National Bank and Syndicate Bank do have close ethnic affiliations with certain sections of the Indian community. In view of these reasons, I feel that Punjab National Bank and Syndicate Bank should be encouraged to have foreign branches, each starting with a branch in London.

3. As you might be aware, the major issues involved in adopting a strategy for Indian banks' branches abroad relate to remittance of foreign exchange and permission, where required, for capital participation on majority or minority basis in existing banks or in new banking ventures including merchant banks. I hope that your meeting on the 25th would come to a decision on these matters.

With kind regards,

Yours sincerely,
R.K. HAZARI

Shri N.C. Sen Gupta
Secretary to the Government of India
Ministry of Finance
Department of Banking
'Jeevan Deep'
Parliament Street
New Delhi

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D.O.No.25(22)–BO.III/74
SECRETARY

MINISTRY OF FINANCE
DEPARTMENT OF BANKING
'JEEVAN DEEP' PARLIAMENT STREET
NEW DELHI
December 10, 1974

My dear Jagannathan,

As regards opening of foreign branches of Indian banks, FM has minuted as follows:-

In the matter of opening branches in foreign countries, we should be generally guided by the RBI, who should have the expertise with them to advise Government in this matter. Let me discuss this with the Governor of the Reserve Bank before we take a final decision. The Governor may be requested to come prepared and speak to me when he comes to Delhi next.

It will be appreciated if you will kindly keep us informed about your next visit to Delhi so that the matter can be examined by FM.

Yours sincerely
N.C. SEN GUPTA

Shri S. Jagannathan
Governor
Reserve Bank of India
Central Office
Bombay – 1

D.O.No.G/8/DBOD/33

April 21, 1975

My dear Sen Gupta,

Please refer to your letter No. 25 (22)-BO.III/74 dated 10th December 1974 regarding the opening of foreign branches of Indian banks in London. As you are aware, it has been possible to discuss this matter in FM's room when all Secretaries of the Ministry of Finance were present.

2. In amplification of what he has already recorded in the minute which has been reproduced in your letter, FM has indicated, as you will recall, that it will be desirable for Government as a normal rule to accept and act on the considered recommendations of the Reserve Bank of India, that as part of this approach, any facts or information which any Government department may have and any suggestions from Government departments, may be passed on to the Reserve Bank, so that they may be taken into consideration, before the Bank's views are finalized. FM's decision/approval will be sought wherever necessary. I think this arrangement will be quite satisfactory.

3. The above two paragraphs are only by way of preliminary remarks. As you are aware, this whole question of bank branches abroad was considered in a systematic way during 1974, first at a meeting of the RBI with the principal banks and as a second step, at a meeting within the Government, convened by the Department of Banking and attended by representatives of the Ministry of External Affairs, of the Reserve Bank, etc. The principles of the approach have been duly settled. We are now concerned only with certain particular cases.

4. As far as the United Kingdom is concerned, it has been our view, as was recorded after the RBI meeting that it should be free and open to any Indian bank which finds it convenient and possible to open a branch within that country. As the question of reciprocity does not arise in the case of the United Kingdom, entry into the UK being free (so far as the British authorities and their regulations are concerned), the only questions which we have to consider are whether it will be in the interests of our own banks to open any new branches in London or elsewhere in the UK.

5. I am enclosing herewith for your information two statements showing the growth in the deposits of the Indian commercial banks in the United Kingdom and the profits remitted to India by the Indian banks from the UK. (The figures are for the years inclusive of 1973. By all accounts, 1974 has been a better year than ever before, for Indian banks' operations abroad.) It will be noticed that the growth in deposits and the profits which have been remitted to India in recent years has been quite substantial. (So far as the State Bank of India is concerned, the increase in profits is, if anything, understated, as that bank has recently made some arrangements for remitting portion of the profits to India in the form of head office expenses, for supervision of the branches in the UK, and the effect of this arrangement is not reflected in the profits, which have been remitted in the past.)

6. London is a growing financial centre and is the most natural and convenient

place for the turnover of funds in various currencies in the Euro-market. In view of the investment of a substantial portion of oil funds in the Euro-market or local in sterling deposits in London, the volume of banking business in London has considerably increased in the last two years or so, and the opportunities for banks to open branches and to run them profitably have also been increased correspondingly.

7. Apart from the above, the London branch of an Indian bank generally caters not only to the requirements of its own constituents in London or within the UK, but also to the needs of the other foreign branches of the Indian banks where there are any. With a branch in London, an Indian bank will be able to utilize the wide range of facilities available in London and get their personnel trained in foreign exchange. The transaction of foreign exchange business through a correspondent will not be an adequate substitute for the opening of a bank's own branch in London. In fact, there will be a saving in the commission, which is now payable to the foreign correspondents, which may be equal to or even greater than the cost of running a London branch. We should, therefore, encourage Indian banks to establish a few more offices in London before the position for some reason, which cannot now be anticipated, becomes difficult.

8. There seems to be no reason from our own experience so far, or on other grounds, to expect that the opening of a few more branches as suggested, will result in a reduction of the deposits or profits of our banks, which are already represented in London or have opened branches elsewhere within the UK. (As conveyed indirectly above, the public sector banks which do not have, as yet, branches in the UK necessarily pay commissions on their foreign transactions, to *foreign* corresponding banks in the UK, and this can be saved when the bank has its own branch in London.)

9. So far as the Reserve Bank of India is concerned, the opening of a few more branches of Indian banks in London may be useful, as we now find it necessary, from time to time, to put out funds in the Euro-market through our banks and it will be desirable if we can deal with a larger number of Indian banks for this purpose, with a view to avoiding a concentration of funds in any one bank. As the possibility that our shipping companies and perhaps at a later stage, a few other concerns may have to borrow larger amounts in the Euro-market, cannot be ruled out, the opening of a larger number of branches of Indian banks within the UK will also facilitate such borrowing, if necessary on competitive terms.

10. It was against this background and after specific consideration that we supported the case of two particular banks.

11. In the circumstances indicated, I suggest that we may permit both the Punjab National Bank and the Syndicate Bank, which have already applied to us, to proceed further with the arrangements for the opening of their London branches. The preliminary expenses in the case of these two banks will be of the order of £31,000 and £30,000 respectively. (The figures of profits actually remitted each year by Indian banks already operating in the UK will show that these non-recurring amounts required as preliminary expenses are quite small, in relation to the benefits expected year after year.)

While the relatively small sums required as preliminary expenses may be sanctioned immediately, the question of granting them permission to remit up to £200,000 in each case towards working capital requirements may be considered after the banks have examined the matter further, have made more precise estimates of the amounts which may be required, and have made these available to us for scrutiny. I would mention that these proposals regarding the United Kingdom will, in no way, interfere with or be allowed to affect our efforts to open banks/branches in the Middle East/West Asia, in countries such as Iran, Lebanon (where there are legal restrictions) or in other countries. Also, in view of the very large amounts in foreign currency that we are already asking our public sector banks to hold abroad on our behalf (see reference to this in para 9), it should be possible to find any small sums required to get the new branches going, without making any real dent on our reserves.

12. I shall be glad if you could kindly confirm that in the light of what I have said we may now grant licences to these two banks to open their London offices.

Yours sincerely,
S. JAGANNATHAN

Shri N.C. Sen Gupta
Secretary
Government of India
Ministry of Finance
Department of Banking
New Delhi

Profits of Indian Banks in UK

	(in Rs lakhs)			
	1970	1971	1972	1973
Bank of India	17.26 (1.86)	9.75 (1.38)	20.00 (2.21)	46.63 (2.59)
Bank of Baroda	8.44 (0.64)	15.54 (0.74)	12.23 (0.85)	18.17 (0.98)
UCO Bank	-1.12	2.40	3.42	11.76
State Bank of India	8.09	8.51	15.49	31.59
Central Bank	-5.12	-5.82	-28.61	-10.72

About Rs 1 crore

Deposit Growth of Indian Commercial Banks in the UK

	(in Rs crores)	
1969	—	62.46
1970	—	73.76
1971	—	76.77
1972	—	105.05
1973	—	111.43
Sept. 1974	—	121.58

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D.O.No.26(4)-B.O.III/78
Baldev Singh
Joint Secretary

MINISTRY OF FINANCE
DEPARTMENT OF ECONOMIC AFFAIRS
(BANKING DIVISION)
'JEEVAN DEEP', PARLIAMENT STREET
NEW DELHI - 1
2.2.1978

Dear Dr Patel,

Under the Banking Regulation Act, 1949, grant or refusal of a licence for banking business for a bank, including a foreign bank, is a function exclusively assigned to the Reserve Bank of India. A convention has, however, developed over the years for the Reserve Bank to consult the Ministry of Finance and for the Ministry of Finance to consult the Ministry of External Affairs before any decision is taken either to give or to refuse a licence to a foreign bank for conduct of banking business, mainly due to the political angle involved in such a decision. Of late, both the Government and the Reserve Bank have received a number of requests from the foreign banks operating in India for expansion of their branch network in India and from other foreign banks for their entry into India. Some canvassing by the banks concerned in support of their applications has also been noticed.

2. There is already a Committee existing for consideration of proposals by Indian Banks wanting to open branches abroad. This Committee consists of Secretary (Economic Affairs), Additional Secretary (Banking), a representative of the Reserve Bank (usually Deputy Governor) and a representative (Secretary or other senior officer) of the Ministry of External Affairs. It is our view that applications received from foreign banks for establishing representative offices or branches in India may be placed for consideration before the same Committee. If you agree, the applications received so far will be placed before the next meeting of the Committee.

With regards,

Dr I.G. Patel
Governor
Reserve Bank of India
Bombay

Yours sincerely,
BALDEV SINGH

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Section 23 of the Banking Regulation Act, 1949
D.O. letter No. 26(4)-B.O. III/78

GOVERNMENT OF INDIA
2nd February 1978

In the D.O. letter under reference, it has been stated that it is the Government's view that applications received from foreign banks either for their entry into our country or for expansion of their existing branch network in our country, may be placed for consideration before the Committee already set up by it for considering

applications received from Indian banks for opening branches abroad. This Committee consists of Secretary (Economic Affairs), Additional Secretary (Banking), representative of the Reserve Bank of India (usually Deputy Governor) and a representative (Secretary or other senior officer) of the Ministry of External Affairs.

2. By virtue of the provisions of sections 22 and 23 of the Banking Regulation Act, 1949, the authority for granting permission to a foreign banking company to establish itself in India or to expand its existing branch network in India or to an Indian banking company to open offices in or outside India vests in the Reserve Bank of India. The Bank is required by law to satisfy itself on certain aspects in this regard before granting the necessary permission. In view of the political implications involved in cases of applications of Indian banks for opening branches abroad and of foreign banks for entry into India or expansion of their branch network in India, we were, in the past, consulting Government before granting such permission by making formal references to them. These formal references used to set out the merits and demerits of the proposals involved and in the light of the views received from Government, the Reserve Bank of India used to take decisions for allowing or disallowing a proposal. In the case of applications of Indian banks for opening offices abroad, it is the Committee of the Central Board of Directors of the Reserve Bank of India which takes the decision.

3. Till April 1974, banks were opening offices abroad after making their own individual assessment of business potential at various centres, after obtaining our permission. In April 1974, the need was felt for making a concerted effort to determine the priorities and explore the possibilities of rapid expansion of individual Indian banks in various countries in a planned and coordinated manner so as to derive the optimum benefit for the country from such expansion. As a first step in this direction, a meeting of the Chairmen of certain selected commercial banks was convened by us on 18th April 1974 for the purpose of considering the various issues involved in the functioning as well as opening of new offices in various countries. At this meeting, a representative of the Government of India was also present. After a detailed discussion on the various issues raised by the bankers, certain tentative decisions were taken in regard to the allotment of countries to various banks. It was decided that in opening branches abroad, banks should be guided not only by profitability but also by the broader aspect of the prospects of generating trade, setting up of joint ventures, etc. The Reserve Bank of India accordingly wrote to the allottee banks to initiate action on the decisions taken at the said meeting.

4. Soon after the above meeting, the Department of Banking convened another meeting at which practically the same issues, which were considered at the meeting convened by Reserve Bank of India, were gone into. At this meeting, a question was raised as to whether it was advisable for banks like Punjab National Bank and Syndicate Bank which had no branches abroad, to consider having branches abroad. It may be relevant to mention that at the meeting convened by the Reserve Bank of India, these banks were considered for expansion abroad. After some discussion, it was decided at that meeting that there was no particular harm in asking these two banks to formulate concrete proposals for consideration of the Reserve Bank of

India and the Economic Affairs Department. After this meeting, the Secretary, Department of Banking issued letters to Chairmen of State Bank of India, Bank of India and Bank of Baroda advising them to send reports periodically to Government of the progress made in undertaking surveys of the places, etc. allotted to them in the meeting convened by the Reserve Bank. The Secretary also stated that he would be holding periodical meetings of the concerned banks to review the progress made in undertaking surveys, opening of new foreign branches, etc., a field which by statute falls within the jurisdiction of Reserve Bank of India. The purport of this letter was not clear to us.

5. The Punjab National Bank and Syndicate Bank, in accordance with the tentative decisions taken at the meeting held by the Reserve Bank of India in April 1974, after survey, submitted to us applications for opening a branch each in London. The Reserve Bank of India supported these applications. When these proposals were put up to the then Finance Minister by Government, he commented as follows: (Vide Government's letter dated 10.12.1974)

In the matter of opening branches in foreign countries we should be generally guided by the Reserve Bank of India, who should have the expertise with them to advise Government in this matter. Let me discuss this with the Governor of the Reserve Bank before we take a final decision. Governor may be requested to come prepared to speak to me when he comes to Delhi next.

Subsequently, the Governor met the Finance Minister. Following the discussion with the then Finance Minister, the Governor wrote on 21st April 1975 to the Secretary (Banking) as under:

In amplification of what he has already recorded in the minute which has been reproduced in your letter, Finance Minister has indicated as you will recall, that it will be desirable for Government as a normal rule to accept and act on the considered recommendations of the Reserve Bank of India, that as part of this approach, any facts or information which any Government department may have and any suggestions from Government departments, may be passed on to the Reserve Bank, so that they may be taken into consideration, before the Bank's views are finalized. Finance Minister's decision/approval will be sought wherever necessary. I think this arrangement will be quite satisfactory.

6. Notwithstanding the above, in August 1975, the Banking Department, without even consulting the Reserve Bank of India, advised all the public sector banks that applications for opening branches abroad, which were, till then, being considered by the Reserve Bank of India, were to be considered by a Committee and that, therefore, all applications for opening branches abroad were required to be submitted to Government directly, and only a copy was to be sent to the Reserve Bank of India. This naturally had the effect of eroding the authority of the Reserve Bank of India. Since then, these proposals are being considered by the above Committee. The former Department of Banking (now Banking Division of Department of Economic Affairs) has been providing secretarial service to the committee, and has also been advising

the banks *directly* of the decisions taken by the Committee. The formal licences are issued thereafter by the Reserve Bank of India.

7. The sequence of events as stated above has already had the effect of lowering the image of the Reserve Bank in the eyes of the banks. A note was recorded in the DBOD on 12th September 1975 expressing unhappiness over the above decision of the Government. In view, however, of the then prevailing circumstances, the Reserve Bank of India did not pursue the matter with the then Government.

8. The present suggestion of the Government, viz., that the above Committee would also consider applications of foreign banks either for their entry into our country or for their expansion of their existing branch network in our country, would indirectly have the effect of further eroding the powers of the Reserve Bank and also, in our view, would lower its image.

9. Another aspect which needs consideration is that under the law, it is the Reserve Bank of India which has been granted the power to grant permission in these cases. In taking a decision, the Reserve Bank can take into account the views of others, viz., Government and this is why in the earlier years, it was consulting Government mainly because of the political implications, involved as Government may have in its possession material which it could pass on to Reserve Bank of India. But by the present procedure, which was unilaterally decided by Government, it has executively abrogated powers which are lawfully vested in the Reserve Bank of India.

10. Yet another aspect is the need for keeping the records straight of both Government and Reserve Bank of India so that at a future date, one will be able to correctly interpret the circumstances and factors taken into account while taking a particular decision. The absence of formal communications between the Reserve Bank and the Government wherein the grounds on which a particular view is supported or otherwise are clearly spelt out in the notes or letters exchanged, may lead to possible suspicion or view that the decisions were taken arbitrarily. Whenever Reserve Bank of India consults the Ministry of Finance on any application received by it, it would be open to the Ministry to have the views of the Ministry of External Affairs or any other Ministry before communicating their views to the Reserve Bank of India. Any facts or information which any Government Department may have or any suggestion from Government could also be passed on to the Reserve Bank so that it may take them into consideration before finalizing its view.

11. In view of the foregoing, we are not in favour of the Committee considering such applications of foreign banks for opening offices in our country. It is also our view that applications of Indian banks for opening branches abroad should be considered by the Reserve Bank of India and the position that obtained prior to August 1975 should be restored, so that the autonomy of the Reserve Bank of India is preserved.

12. If Governor approves, we may send a copy of this note to Government as in the draft forwarding letter below.

P. VENKATESWARAN
24.02.1978

(In my view, this is a matter on which the present position is quite unsatisfactory. Every time we put up a memorandum to the Board regarding opening of foreign

branches by Indian banks, we are merely asking the Central Board to endorse a Government decision. This is not right for either the RBI or the Government. Since under the statute, RBI is the authority to grant the licences, the processes should in both form and substance, conform to the statutory provisions. Hence, we shall take up the matter with Government and set right the machinery. To do so does not clearly imply any reduction in RBI having to consult with, and generally respect the views of Government.)

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D.O.No.25(6)-BO.III/78
Baldev Singh
Joint Secretary

MINISTRY OF FINANCE
DEPARTMENT OF ECONOMIC AFFAIRS
(BANKING DIVISION)
'JEEVAN DEEP' PARLIAMENT STREET
NEW DELHI - 1
31.3.1978

Dear Dr Krishnaswamy,
Kindly refer to Dr Manmohan Singh's D.O. letter No. 1795-SEA/78 dated the 28th March 1978 regarding the next meeting of the Inter-Departmental Committee to consider the proposals submitted by various public sector banks for opening of branches, etc. abroad. This is to clarify that the agenda for the above meeting will be confined only to proposals of Indian banks for opening branches/representative offices abroad. A revised list of agenda items is enclosed in supersession of the earlier list of items enclosed with the Economic Secretary's letter.

With regards,

Dr K.S. Krishnaswamy
Deputy Governor
Reserve Bank of India
Central Office
Bombay

Yours sincerely,
BALDEV SINGH

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D.O.DBOD.No.BL.930/C553(A)-79

February 7, 1979

My dear Manmohan,
You will recall that last week we had discussed with the Dy. Prime Minister and Finance Minister the policy with regard to foreign banks opening branches in India. It was confirmed that we continue to adopt a restrictive policy in allowing foreign banks to open branches in India, and within this restrictive policy, we aim at diversifying the presence of the international banking community in India, and not enlarging that part of the international banking community which is already

represented in the country. Accordingly, the UK and the USA banks will not be encouraged to enlarge their presence in India and we would prefer opening of new branches in India by banks from countries not already represented in India but where Indian banks have branches. The principle of reciprocity will be a major consideration in dealing with these cases, although it would not be desirable to try and quantify how exactly 'reciprocity' is to be defined. This will naturally vary from region to region.

2. Although the question of foreign banks opening representative offices in India was not discussed, we may take a fairly liberal view making it absolutely clear to the banks concerned that our agreeing to the opening of the representative office does not, in any way, confer a claim or privilege for setting up a branch office later.

3. With regard to Indian banks opening offices abroad, it is our opinion that not every bank need go abroad, but only the bigger ones which have developed the necessary expertise need be permitted to go. Wherever feasible, we should encourage joint efforts by a few nationalized banks rather than encourage them to compete with each other for the sake of so-called 'prestige'. This approach implies that instead of taking ad hoc decisions in responses to pressure or persuasion from individual banks, we should prepare a perspective plan for the next few years for Indian banks opening branches abroad. It is in this light that we had invited proposals from selected nationalized banks and had planned to call a meeting of these banks to discuss the matter within the broad framework of the policy outlined above. However, as you have convened the Inter-Departmental Committee meeting on the 8th instant, I have deputed Shri Bhuchar to attend the same (in the absence of Dr Krishnaswamy) with the instruction that if the consideration of some of the doubtful cases cannot be deferred, he should take, on behalf of the RBI, the stand that may be consistent with the general approach I have outlined above. The private sector banks need not be allowed to open branches outside the country, at least for the present.

4. I would be grateful if you could let me know whether the general approach in this letter is also acceptable to the Ministry of Finance so that we may not act at cross purposes—and, what is more important, do not encourage our own banks to play us one against the other. Between the Ministry of Finance and the RBI there should, in fact, be informal discussion and agreement on individual cases before we discuss them at a general meeting, as otherwise the danger I apprehend would be difficult to avoid. That is why we had earlier suggested a reconsideration of the present procedure which, to say the least, puts the RBI in an awkward position; and I hope that it would be still possible for us to evolve something better than the present procedure which puts us more in the role of, at best, a public prosecutor rather than at least a member of the judiciary.

With best regards,

Dr Manmohan Singh
Secretary, Ministry of Finance
Department of Economic Affairs
Government of India, New Delhi

Yours sincerely,
I.G. PATEL

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D.O.No.1011—SEA/79

GOVERNMENT OF INDIA
MINISTRY OF FINANCE
DEPARTMENT OF ECONOMIC AFFAIRS
NEW DELHI
February 15, 1979

Dear Dr Patel,

Kindly refer to your D.O.No. DBOD No. BL.930/C 553(A)-79 dated 7th February 1979. We are in full agreement with you concerning the policy with regard to foreign banks opening branches in India. With regard to the Indian banks opening offices abroad, we were awaiting the results of the meeting which RBI had proposed of the nationalized banks to discuss the matter. Meanwhile, however, we were informed by the Chief Officer, DBOD, that since a large number of applications for opening offices abroad were pending, it might be worthwhile convening a meeting of the inter-departmental committee. It was in the light of the suggestion which was made by him at Poona that we took the decision to call a meeting without awaiting the results of the discussion which RBI was proposing to have with the nationalized banks.

2. There is, of course, no question of the general policy approach outlined by you not being accepted by us, and if you wish that the existing procedures for the clearing of the proposals of Indian banks for opening offices abroad needs to be changed, we could certainly do so. The fact of the matter is that, as you know, our proposals require consultation with the Ministry of External Affairs; also the bank concerned has to apply for permission to remit funds abroad. We ourselves in the Department of Economic Affairs may have views about the desirability or otherwise of individual nationalized banks deploying their resources in opening of offices abroad. It was in the light of these considerations that, in the past, an inter-departmental committee was set up for expeditious clearing of proposals, and it is a matter of record that RBI's advice has been a major guiding principle in deciding such proposals. We believe that the inter-departmental committee (which consists only of representatives of DEA—banking and foreign exchange wings, RBI and MEA) expedites the process. We are not, however, wedded to any particular procedure. Should you think that the Committee be disbanded and an alternative procedure evolved, we can jointly consider this.

With kind regards,

Dr I.G. Patel
Governor, RBI
Bombay

Yours sincerely,
MANMOHAN SINGH

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March 1, 1979

My dear Manmohan,
 Kindly refer to your D.O. letter No. 1011-SEA/79 dated 15th February 1979. I am sorry that I was not aware that the meeting was called at our instance. Somehow, I also had the feeling that the banks concerned are also present at such meetings. In the light of the position as you have stated in your letter, I see no reason for making change in the present practice. However, as already arranged, Dr Krishnaswamy will take a meeting with the banks soon where their plans for the next two or three years could be discussed to avoid ad hoc decisions. It would be an advantage if someone from the Banking Division is also present at that meeting.

With best regards,

Yours sincerely,
 I.G. PATEL

Dr Manmohan Singh
 Secretary
 Government of India
 Ministry of Finance
 Dept. of Economic Affairs
 New Delhi

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D.O.No.25/11/80-BO.III
 R.K. Kaul
 Additional Secretary

MINISTRY OF FINANCE
 DEPARTMENT OF ECONOMIC AFFAIRS
 (BANKING DIVISION)
 'JEEVAN DEEP' PARLIAMENT STREET
 NEW DELHI - 1
 August 12, 1981

Dear Dr Patel,
 Kindly refer to Dr Krishnaswamy's D.O. letter No. DBOD/BL/3090/C 212 (A) 3-80 of April 16, 1980, forwarding a draft of the policy guidelines to be followed in the matter of permitting Indian banks to open branches, representative offices, subsidiaries, joint ventures abroad, etc.

2. Government have considered the matter in detail. The view taken is that, having regard to the political, foreign exchange and other factors involved in opening offices of Indian banks abroad, it would be desirable to obtain Government's approval 'in principle' for opening branches/offices, etc. of our banks abroad as well as for participation in the equity capital of foreign banks or institutions. The inter-departmental committee, which is already in existence, will continue to carefully examine the proposals and make suitable recommendations to the Government. Government's approval, with or without modifications, will be communicated to the RBI. The Indian banking companies should, however, not normally submit formal applications for licences to the central banking authorities

of other countries without first obtaining approval of the RBI/Government of India.

3. The minutes of the inter-departmental committee meeting held on 11th June 1980, as approved, are sent herewith. It may be desirable to have a further meeting of the inter-departmental committee as soon as it may be convenient so that, having regard to the existing circumstances, specific proposals, if any, for opening offices abroad by different banks could be considered further.

With kind regards,

Dr I.G. Patel
Governor
Reserve Bank of India
Central office
Bombay – 400 001
Encl.: as above.

Yours sincerely,
R.K. KAUL

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No. 228–SDB/70

MINISTRY OF FINANCE
DEPARTMENT OF BANKING
NEW DELHI
May 20, 1970

My dear Adarkar,

I mentioned to you over the telephone yesterday the fact of discussions in Lok Sabha and Rajya Sabha on the sensational, and somewhat enigmatic, happenings in the London branch of Central Bank of India. Enclosed are a copy each of the 'uncorrected' versions of the two discussions, the brief and the note for pad which had been put up to the Ministers the previous day. You would also have noticed various newspaper reports in the country and in UK. The two debates, as you can see, have given many persons rather unpleasant impressions.

Shri V.C. Patel was with us here yesterday at our request. He will, no doubt, see you and Dr Hazari.

There are many strands in the unpleasantness as the papers referred to in the first paragraph above will bear out. In particular, serious misgivings have arisen as to why branches abroad of Indian banks appear to be left on their own and are not subjected to anything like adequate supervision and surveillance from India, particularly from the headquarters of the bank concerned and the Reserve Bank. It appears difficult to avoid altogether the impression that the internal audit of branches abroad by the headquarters of the bank is very weak, if it exists at all; also, that the auditors in the countries abroad where the branches are located may not have been selected carefully and are not seen to be doing their jobs effectively and with some degree of care which the Indian public may expect (personally, I have in mind the question whether these foreign auditors should not have gone into the quality and strength of the links between the London office and the headquarters of the bank in Bombay); furthermore, how much responsibility the Reserve Bank

has assumed so far and is able to assume now in the matter of checking that the branches abroad of Indian banks function properly is not clearly known. To take the last point, for instance, we ourselves are not sure why the London branch could not be visited by Reserve Bank Inspectors for so many years.

Suspensions will continue to linger that if a sensational fraud can have occurred in the London branch of Central Bank, frauds of a similar kind or other kinds may have occurred, or can occur in branches abroad of other Indian banks.

The subject, though a difficult one, merits very early and thorough attention. We shall be grateful if the Reserve Bank examines all the facets of the problem and lets the Government have a full report with indications of what it proposes to get done through the banks, what it itself intends to do and what, if anything, it would like the Government to do.

With kind regards,

Yours sincerely,
A. BAKSI

Shri B.N. Adarkar
Governor, Reserve Bank of India, Central Office, Bombay – 1

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D.O. No. 1

May 26, 1970

My dear Baksi,

I have received your letters of 20th and 22nd May 1970 regarding the Central Bank case. As you have rightly observed, the case raises so many issues requiring early and thorough investigation. We should take them up one by one. In this letter, I propose to deal briefly with only one aspect, viz., the Reserve Bank's inspections.

2. An inspection of foreign branches of Indian banks was carried out in 1960–62. During the discussion on the subject at the Central Board meeting in October 1961, a decision was taken at the instance of the then Governor, Shri H.V.R. Iengar that such inspections need not be carried out more often than once in three years. The reasons given were (1) that they were expensive and (2) that by and large the foreign branches were found to be working on the right lines. In February 1965, this question was taken up again and the then Deputy Governor, Shri C.S. Divakar, and Executive Director, Shri D.R. Joshi, decided that the matter be deferred for some time. In November 1967, the position was reconsidered and in February 1968 a decision was taken to resume the inspections of foreign branches. I was then in charge of DBOD and was concerned with this decision.

3. In resuming the inspections of foreign branches, we gave priority to the branches in Asia and Africa. In view of the obvious importance of London and UK, it was assumed that the branches there would be in charge of senior and responsible officials and could, therefore, be taken up after the inspection of Asian and African branches was over. The last Reserve Bank inspection of the affairs of the Central Bank, as a whole, took place in 1968 and a report of that inspection showed that the London branch, unlike many other branches of the Central Bank, was earning

profits. The 1968 report, however, referred for the first time to the irregularities in the accounts of Montex, C. Raman and the Trevor Group of accounts; this Report was finalized in May 1970 only.

4. The various functions of the Reserve Bank assume different priorities according to the needs and exigencies of the time. For a number of years up to 1960–66, the Reserve Bank's main preoccupation was to bring about the elimination or mergers of a number of small banks which were then tottering or in a semi-solvent state. The inspection staff which is naturally drawn from the more senior and experienced personnel had to be deployed for that purpose. It was this consideration which must have weighed with the Board in agreeing to inspection of foreign branches at long intervals. From 1967 onwards, the accent of Reserve Bank's policy has been on reorganization and development which also require the services of the Bank's senior and experienced personnel. Under the scheme of Social Control, the reorganization of the Boards had to be carried out within a time limit. It was also incumbent on the Reserve Bank to generate a tempo of development work in order that Social Control may show results, within a reasonable period of time, in terms of branch expansion and increases in lending to agriculture and small-scale industries. A big effort had to be mounted to achieve an increase in the number of new branches from the neighbourhood of 350 or so to 700 and later 900 or 1000 per year, and to bring about the necessary adaptation in the commercial banks' personnel and policies for increased lending to priority sectors. This shift in emphasis resulted in lower priority being accorded for some time to mere policing work. It should not be assumed that such work was neglected, but the more expensive types of action (like inspection of foreign branches) where experienced personnel had to be deployed for long periods and at considerable expense were undertaken on a smaller scale. After all, no amount of policing by the Reserve Bank, which, in any case, has to be carried out on a selective, sampling basis, can be an effective substitute for the bank's internal management especially when the bank concerned is one like the Central Bank with a vast network of branches. This bank has been found to be seriously deficient in the matter of internal checks and balances, and its practices in regard to the selection and posting of personnel are deplorable. Under the Banking Regulation Act, the Reserve Bank's control over personnel was limited to the Chief Executive Officer, and through him, to such other members of staff as were really found to be indulging in malpractices or lacking in efficiency. The degree of control which we shall exercise hereafter in the matter of personnel was not exercised prior to nationalization.

5. The internal working of commercial banks in India has so many deficiencies that it is a matter of surprise that the number of frauds actually occurring is so small. Over the last few years, we have been trying to improve the working in many respects, but this is a task which will take some years to be fully accomplished. My four years of hard work in the DBOD were not enough. There are a number of areas where it is essential to improve our inspection procedures and also bring about radical changes in the internal working of banks. I shall write another letter to draw attention to those areas. While doing so, I would ask you to appreciate that given the limitations of personnel and the importance and urgency of developing

the social aspects of banking, the Reserve Bank could not possibly do all it wished by way of cleaning up the internal working of banks. In fact, it was the Reserve Bank's excessive preoccupation with mere policing that had led to the development work being somewhat neglected, prior to the introduction of social control. I recognize, however, that both development and improvement of personnel and procedures must now be pursued simultaneously and with equal vigour.

6. I am personally investigating the Central Bank case and shall write more in subsequent letters.

Shri A. Baksi
Secretary
Department of Banking
Ministry of Finance
Government of India
New Delhi

Yours sincerely,
B.N. ADARKAR

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D.O. No. 2

May 26, 1970

My dear Baksi,

Following certain internal discussions and a discussion with Shri V.C. Patel and his two colleagues, I am sending you this further report about the Central Bank case. I hope my observation in the other letter sent today that the Reserve Bank was not able to accomplish all that it wished in the matter of improving the internal working of commercial banks does not give you the impression that the Reserve Bank neglected this aspect. What I wish to convey is that the internal working of some of the banks is so defective that the effort required to set it right has to be much greater than what the Reserve Bank has been able to put in with its limited personnel and the demands of other equally important matters. I am giving below a list of the points on which the Central Bank has been asked to furnish its explanations, and my observations on some of them will help to illustrate the state of affairs in its internal working.

1. The bank has been asked to prepare a responsible and authentic account of the developments relating to the fraud at the London Office and to submit it not later than the close of business tomorrow. DBOD has been asked to undertake a special scrutiny of all proceedings at the Head Office of the bank in relation to its fraud. It has started the work this afternoon.

2. Shri Patel has confirmed that apart from half-yearly audits conducted by the bank's external auditors, viz., Messrs Fergusson, Rolland & Davis, the bank has not carried out any periodical inspections of the London Office so far. Three ad hoc inspections were carried out in 1966, 1968 and in October 1969. The Inspector who carried out the October 1969 inspection has not submitted a comprehensive report but has sent various letters. The bank has been asked to let us have copies of

the 1966 and 1968 reports and also the letters from the Inspector who visited London in October 1969. The half-yearly audit reports are sent to the Head Office as well as to the bank's statutory auditors, Billimoria & Fergussons. It will be examined how far the statutory auditors as well as the auditors in London have done their duty.

3. The bank has been asked to explain whether the audit reports caused any concern to the Head Office, especially in regard to the advances referred to in Shri Mewawala's report, what action was taken by the Head Office, and whether these irregular accounts were reported at any time to the Board. It is our intention to ascertain how far the Board acquiesced in the irregularities brought to their notice. Montex and G. Ramon & Co. have been allowed an advance of over £360,000 whereas the limit sanctioned by the Head Office for Montex was only £100,000. This irregularity has been going on for a long time and it needs to be ascertained whether there was any failure on the part of the management to bring it to the notice of the Board or whether the Board also connived at it.

4. It is understood that the external auditors have been auditing the London office ever since it was opened on 14th August 1953.

5. DBOD will examine the entire proceedings leading to the acceptance of Shri Sami Patel's resignation. Shri Patel offered to resign on the 9th and Shri Mewawala accepted his resignation on the 26th after consulting the Head Office. The bank had sufficient time to consult Government in the matter but did not do so. Shri Sami Patel continued to work in the bank from 9th March to 26th March and, according to press reports, he put through some more irregular transactions. The development between 9th March and 26th March will be studied.

6. DBOD will also study the returns received from the London Office regarding advances, securities and guarantees, in order to ascertain how far the Head Office was aware of the irregularities and what action was taken by them to check them. It is understood that the returns are processed by a section in the Branch Inspection Department which is headed by one Mrs Peston Janasp. She has remained in this position for the last five or six years. An Assistant General Manager, Shri Premahi, was supervising her work, and since he retired in October 1969 she has been reporting directly to Shri Mewawala, General Manager.

7. DBOD will examine the bank's records regarding: (a) the sanctioning by the Head Office of the advances, bill limits, guarantees, etc. which have been referred to in the inspection reports and Shri Mewawala's Report, (b) the system of obtaining credit reports on the parties, (c) the extent to which powers had been delegated to the London Manager and the Adviser, and (d) the borrowing powers delegated to the London office. Shri Patel said that when the branch was opened special discretionary powers were given to the London Manager, and these were exceeded by him. It needs to be examined what kind of powers had been delegated by the Head Office to the London office. The advances at the London Office exceeded the deposits which meant that the London office was allowed to borrow in London or that the Head Office provided additional resources. The factual position is to be ascertained.

8. Shri Sami Patel was continuously in London for over fourteen years. The bank has been asked to explain whether his transfer to India was considered at any

time and, if so, who opposed it. It is a regular feature of all bank frauds that the person concerned is found to have remained at the same post for a number of years. This was the feature of the fraud involving Rs 41 lakhs at the Central Bank's Relief Road Branch at Ahmedabad. The bank is being asked to report to us all cases in which the Chief Managers, Managers and Accountants have remained at the same post for more than five years.

9. It is also being ascertained whether any payments have been made against the bills in question, whether by the London office or by anybody else.

10. The bank has been asked to find out whether Shri Patel, his wife or any concern with which they were associated had accounts with the London office and they were allowed to withdraw the balance in these accounts. The bank has also been asked what action, if any, they are taking about the operations on any accounts which Montex or G. Ramon & Co. have with the Head Office or other offices of the Central Bank.

11. We shall have to take stricter action in respect of this bank in regard to the following matters:

- (a) Responsible positions being held by the same individuals for too long a time.
- (b) Internal inspections, particularly in regard to the tendency of individual officers to defeat internal checks by performing functions or exercising powers normally assigned to other officers.
- (c) The processing of returns from branches and reporting irregularities to the Board.
- (d) The manner in which certain records are maintained. (After the fraud at Ahmedabad, Billimorias, at our request, had formulated certain suggestions in regard to the maintenance of bill registers, etc. and since a similar fraud has subsequently occurred at Calcutta, we have to satisfy ourselves that those suggestions were actually implemented by the bank.) At Calcutta, an instance has occurred of the bank discounting bills for Rs 9 lakhs on behalf of parties which are non-existent but in respect of which its Cash Department had earlier produced a favourable credit report.
- (e) The bank's instructions to London regarding the procedure to be followed in issuing guarantees, etc. will also be studied.

12. The above is only an illustrative list intended to stimulate inquiry. If you have any additional points, to suggest, kindly do so.

Shri A. Bakshi
Secretary
Department of Banking
Ministry of Finance
Government of India
New Delhi

Yours sincerely,
B.N. ADARKAR

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RESERVE BANK OF INDIA
 AGRICULTURAL CREDIT DEPARTMENT
 CENTRAL OFFICE
 GARMENT HOUSE, P.B. No. 16575
 BOMBAY 400 018
 23 May 1975
 2 Jyaistha 1897(S)
 Ref. No.ACD.Plan.3720/PR.428(1)-74/5

The Registrar
 Cooperative Societies

Dear Sir,

LINKING BORROWINGS FROM THE RESERVE BANK WITH EFFORTS AT DEPOSIT MOBILIZATION
 BY CENTRAL COOPERATIVE BANKS—MODIFICATIONS IN THE SCHEME

Please refer to our circular letter No. ACD.Plan 467/PR 428(1)-72/3 dated 17 August 1972, communicating the main features of the scheme for linking of borrowings from the Reserve Bank with efforts at deposit mobilization by central cooperative banks. Under the scheme, which was introduced with effect from the year 1973-74, the rate of interest charged by the Reserve Bank on short-term agricultural advances to state cooperative banks on behalf of central cooperative banks was raised from 2 per cent below the 'Bank Rate' to $\frac{1}{2}$ per cent below the 'Bank Rate'. The central cooperative banks were, however, allowed a rebate of $1\frac{1}{2}$ per cent (a) on their borrowings from the Reserve Bank equal to the 'base level' and (b) on borrowings over and above the 'base level' up to twice the increase in their involvement in short-term agricultural loans out of their own resources or to the full extent of the loans granted by them to small/marginal farmers, whichever is higher. In terms of the recently introduced provisions of the Interest Tax Act, 1974, scheduled state cooperative banks are liable to pay tax at the rate of 7 per cent in respect of their chargeable interest. From the legal position as it stands at present, it appears that the state cooperative banks would be liable to pay interest tax on the higher rate of interest initially charged by them to the central cooperatives banks, even when rebate admissible under the deposit mobilization scheme is passed on to the latter banks. The state cooperative banks would thus have to suffer a double disadvantage, first by granting rebate to district central cooperative banks at $1\frac{1}{2}$ per cent, and then paying interest tax on the amount of interest collected without taking into account the rebate.

2. The above problem was considered by the Standing Committee on Linking Borrowings with Deposit Mobilization, as its second meeting held at Bombay on 4 April 1975. In view of the fact that, if the scheme is continued in the present form, the scheduled state cooperative banks might have to face considerable losses, the committee decided to modify the scheme in a manner which will involve charging a lower rate of interest earlier and granting rebate later. The revised scheme, as proposed by the Committee, is as under:

The Reserve Bank's rate of interest on loans and advances to state cooperative banks on behalf of all central cooperative banks for seasonal agricultural operations

will be fixed at 2 per cent below the 'Bank Rate' with effect from 1 July 1975 on (a) that part of the borrowings of the state cooperative banks which represents the 'base level' up to twice the increase in the involvement of the central cooperative banks out of their own resources in agricultural loans, or to the full extent of increase in the loans granted by it to the small/marginal farmers, whichever is higher. The borrowings of a central cooperative bank in excess of the above amount, if any, will be charged interest at $\frac{1}{2}$ per cent below the 'Bank Rate'. An agreement between the Reserve Bank and state cooperative banks on the one hand, and between the latter and the central cooperative banks on the other, will authorize the recovery of interest at the higher rate on a part of the borrowings of the state cooperative bank, as the case may be.

The interest charged by state cooperative banks to central cooperative banks will also be on the same pattern.

3. The recommendations of the Committee in this regard have since been accepted by the Reserve Bank of India, and it has been decided to introduce the scheme modified as above, with effect from 1 July 1975. Detailed instructions regarding operational procedures to be followed under the modified scheme, as also the revised agreements, etc., will be sent to you shortly.

4. We shall be glad if the contents of this circular are brought to the notice of state and central cooperative banks in your state.

Yours faithfully,
M.V. HATE
JT. CHIEF OFFICER

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Ref.No.ACD.Plan.5591/PR.484/75/6

23 September 1976
1 Asvina 1898 (Saka)

The Secretary
Cooperation Department
Government of India

GUIDELINES FOR THE IMPLEMENTATION OF THE RECOMMENDATIONS OF THE
EXPERT COMMITTEE ON CONSUMPTION CREDIT

As you are aware, the Government of India had appointed in March 1976, an Expert Committee on Consumption Credit under the chairmanship of Shri B. Sivaraman, Member, Planning Commission, to suggest measures for meeting the consumption credit needs of small farmers, landless labourers, etc. consequent on the steps taken by the state governments for moratorium and in charge and scaling down of debts from non-institutional sources. The recommendations of the Committee were discussed at a conference of the Chief Ministers of small states convened by the Finance Minister at Bangalore on 16 June 1976 and were generally endorsed.

2. One of the recommendations made by the Committee was that the Reserve Bank of India should issue necessary guidelines to the cooperative and commercial

banks for expeditiously implementing its recommendations. Accordingly, we have prepared guidelines keeping in view the recommendations of the Committee and the decisions thereon taken at the Bangalore conference. A copy of the guidelines is enclosed for immediate implementation.

3. The guidelines contain the details of the steps to be taken for the reorganization of primary agricultural credit societies into variable units, each having a full-time paid secretary and the procedure for amalgamation of the societies. Details of the steps required to be taken by the cooperative banks and the societies in the matter of recovery of overdues, deposit mobilization, nature and scope of consumption loans that may be issued by them, etc. are also indicated in the guidelines. The institutions may be suitably advised in the matter immediately.

4. Your attention is invited, particularly to paragraphs 6 and 17 of the guidelines wherein we have suggested the amendments to the Cooperative Societies Act with a view to expediting the amalgamation of non-viable societies, and also providing for the right of prior claim of the society over the crops of the members even in respect of the consumption loans issued to them. Steps may be taken to amend the Cooperative Societies Act with such modifications as may be necessary in the light of the existing provisions in the Act, if necessary, by issue of an Ordinance for this purpose.

5. Item VII of the guidelines relates to the terms and conditions governing loans from the Bank's long-term Operations Fund to the state governments for contribution to the state governments' share capital of reorganized primary societies. It may be seen that the terms and conditions have been further liberalized by us.

6. We are endorsing a copy of this letter to the Registrar of Cooperative Societies and to the state cooperative bank of your state for their information and immediate action.

7. We shall be glad if you kindly advise us as soon as possible of the action taken in the matter.

I. Guidelines for the Implementation of the Recommendations of the Expert Committee on Consumption Credit

1. *Reorganization of Primary Agricultural Credit Societies*

The Committee had recommended that only such of those reorganized societies including FSS and LAMPS which are having full-time paid secretaries or managers should undertake the issue of consumption loans to their members. In this connection, the Committee had emphasized the need for expeditious completion of the reorganization programmes which have already been taken up on hand by most of the states, and which will have to be implemented vigorously in pursuance of the decisions taken at the meeting of some of the Chief Ministers held at Bangalore on 16 June 1976. It is expected that in the next few months, a large number of primary societies will be reorganized and have full-time paid secretaries.

2. The problems connected with the reorganization of the societies as also those of merger or liquidation of the non-viable societies were discussed recently at a meeting convened by the Reserve Bank of India in Bombay on 4 May 1976.

According to the decisions taken at the meeting, the following steps should be taken by the state governments to expedite the programmes:

- (i) For the purpose of viability, account should be taken of the short-term agricultural credit business only. The other business, viz., medium-term, long-term agricultural credit and consumption credit should be taken as additional potential.
- (ii) Normally, a gross cropped area of 2,000 hectares (5,000 acres), whether irrigated or not, might be taken as adequate to provide a minimum short-term credit potential of Rs 2 lakhs for the reorganized society.
- (iii) In cases where more than 2,000 hectares were to be covered, the area of operation of the organized society should be confined to a radius of 10 kms only, excepting in hill or tribal or desert areas, so however that the jurisdiction of a society did not cut across the village boundaries.
- (iv) Where a village was big and had more than 2,000 hectares, a detailed exercise with reference to actual scales of finance might have to be done to ensure a minimum short-term credit business of Rs 2 lakhs on the assumption that the society would be able to meet only about 40 per cent of the potential calculated on the above basis.
- (v) In the proposed area of less than 2,000 hectares, a detailed exercise with reference to actual scales of finance might have to be done to ensure a minimum short-term credit business of Rs 2 lakhs on the assumption that the society would be able to meet only about 40 per cent of the potential calculated on the above basis.
- (vi) If one administrative unit like gram panchayat or patwar circle did not have in its jurisdiction 2,000 hectares of gross cropped area, two or more such administrative units might be covered by the reorganized society wholly, in which case the territorial limit of 10 kms radius might not be applied. Preferably, in such cases, farmers' service societies of the smaller model might be organized, instead of a viable primary agricultural credit society. However, the society should not be again reorganized if on a subsequent date, the area of the gram panchayat is altered.
- (vii) Where a society had already attained a short-term loan business of Rs 2 lakhs, it might not be normally disturbed but could be made the nucleus of a farmers' service society (FSS), a large-sized multi-purpose society (LAMPS) or a reorganized primary agricultural credit society.
- (viii) If once the area is decided, good working societies might be merged with the nucleus society selected for retention and the non-viable ones liquidated.

3. The above guidelines do not require any fresh survey. In some of the states, the programme of the organization may have reached an advanced stage of implementation. However, the state governments should have a second but quick look at the area of operations of the reorganized societies with a view to ensuring that ordinarily each such society covers a gross cropped area of not less than 2,000 hectares and not more than a radius of 10 kms. Certain marginal adjustments would be necessary only in cases where these conditions are not satisfied. In this connection, reference may be made to the detailed guidelines issued under cover of the

Agricultural Credit Department's circular letter No.ACD.Plan 5115/PR.55(1)-75/6 dated 28 May 1976 addressed to all the state governments on this subject. As suggested therein and as urged by the Expert Committee on Consumption Credit, vigorous steps have to be taken by the state governments to reorganize as many primary credit societies as possible into viable societies immediately. All the reorganized societies should be provided with full-time paid managers/secretaries. The cost of these managers may have to be subsidized initially by the state governments for which purpose they may make adequate provision in their budgets for the year 1976-77.

II. Merger or Liquidation of Non-viable Societies

4. Having identified the area appropriate for a viable society and also selected a good working society which could be retained and reorganized, the position of the other existing societies in the area should be quickly decided. They may either be liquidated or amalgamated. In order to ensure that the reorganized viable society/FSS/LAMPS are not burdened from their very inception with the bad debts and overdues of the amalgamating society, it is necessary that those falling under any of the following categories may straightaway be taken into liquidation:

(i) A society whose estimated bad debts (as per the latest available audit report) exceeded its owned funds, that is, share capital plus all reserves.

(ii) A society which has been dormant for over three years.

(iii) A society which has been classified as 'D' in the latest available audit report.

2. Care will have to be taken to see that in merging the other societies with the viable society/FSS/LAMPS, the latter's financial position is not adversely affected. If the aggregate value of the bad debts of a society meant for merger exceeds its reserves but is within its owned funds, the bad debts should be set off against the reserves, and also against share capital to the extent necessary and the book value of the share capital should be brought down to its real value. The detailed procedure in this regard is indicated in the Agricultural Credit Department's circular letter No. ACD.Plan.5113/PR.55(1)-75/6 dated 28 May 1976 addressed to the state governments.

3. Amalgamation of two or more societies as per the procedure suggested in para 4 of the ACD circular letter No.ACD. Plan/5113/PR/55(12)-75/6 may not be feasible without the necessary statutory provision in the Cooperative Societies Act. Although presently, most State Cooperative Societies Acts provide for either voluntary or compulsory amalgamation of two or more societies, the provisions of these enactments are deficient in several respects, with the result that state governments experience considerable difficulty in pushing through the reorganization programme. Moreover, most of the State Cooperative Societies Acts do not empower the state governments to reduce the value of the share capital of the amalgamating societies. It would be necessary to vest such powers with the state government if the procedure for amalgamation outlined above is to be followed. The State Cooperative Societies Acts would, therefore, have to be suitably amended providing for compulsory amalgamation of societies and vesting the Registrar with adequate powers with a view to expediting the process of amalgamation. A draft of

the model section which could be incorporated in the Cooperative Societies Acts has since been communicated to the state governments vide circular letter No. ACD.Plan.5347/PR.(1)-75/6 dated 14 June 1976. The same may be adopted by them with such modifications as may be necessary in the context of the existing provisions in the State Cooperative Societies Acts.

4. Pending merger of the weak societies with the one identified for retention, the area of operations of the latter may be extended to cover the area of those marked for liquidation or amalgamation, and non-members may be admitted to the society marked for retention and financed by it. There may be no harm even in admitting a non-member to this society, provided care is taken to see that he does not receive accommodation from the old society. Such a person may hold only one share for the time being, of the new society, and for the purpose of borrowing from it, his shareholding in the old society may be reckoned as available for accommodation from the new society, for after merger he would be holding shares to a corresponding extent of the new society.

III. Recovery of Overdues of Cooperatives

8. The Expert Committee on Consumption Credit has emphasized that the cooperative institutions and the state governments should launch a vigorous drive for the collection of overdues of the cooperatives. Such recovery would release the owned funds of the institution, that is, the central banks and the primary societies, which are presently locked-up in overdues, for the purpose of issuing consumption loans. For achieving this end, the following steps, in particular already recommended by the Study Team on Overdues of Cooperative Credit Institutions have to be taken by the State governments, if not already done.

- (i) Creation of favourable climate by the state governments themselves which may include denying credit to defaulters of societies and not granting blanket stay orders on the execution of the decrees obtained by cooperatives.
- (ii) Strengthening of the existing machinery in the Cooperative or Revenue Departments for expediting the arbitration and execution cases against defaulters.
- (iii) Denial of voting rights to the defaulters of societies and automatic supersession of the board of directors of central banks and managing committees of societies in the overdues exceeded a certain level for a specified period.

5. The recommendations of the Study Team on Overdues were communicated to the state governments in terms of the Agricultural Credit Department's Circular No.ACD.Plan.1239/PR.475-74/5 dated 15 July 1974 for implementation. The state governments should review the progress in the implementation of these recommendations and take further immediate steps to ensure complete compliance.

IV. Augmentation of Resources

6. Among the measures suggested by the Committee for augmenting the resources of the cooperative institutions for facilitating the issue of consumption loans, the most important steps relate to deposit mobilization. In this connection, the

Committee has cited the success achieved by cooperatives in Kerala in mopping up resources from the rural areas. The broad features of the scheme were as under:

- (i) A decision was taken at a meeting convened by the Chief Minister in February 1976 for making intensive efforts for deposit mobilization in April 1976 by celebrating the month as a 'Deposit Mobilization Month'.
- (ii) A target of Rs 20 crores was fixed to be reached during April 1976 as follows:
- (iii) The Government set up committees consisting of officials and non-officials at the village level, taluka level, district level and state level for canvassing of deposits.
- (iv) To pursue the campaign on a day-to-day basis and to review its progress on a weekly basis, a small steering committee consisting of the President, Kerala State Cooperative Bank Ltd.; Chairman, State Cooperative Union; Secretary to the Government, Planning Development; Registrar of Cooperative Societies and Secretary, Kerala State Cooperative Bank was also set up.
- (v) The Chief Minister and other ministers held press conferences on the campaign. A minister was named for each district to supervise and guide the operations. The President of the State Cooperative Bank, Chairman of the State Cooperative Union and the Presidents of the Central Cooperative Banks also met the press on different dates to explain the significance of the campaign by issuing special supplements in important local newspapers. The Government had asked the Director of Public Relations to render the necessary publicity support to the scheme.
- (vi) The state cooperative bank collected information relating to the position of deposits in each institution as on 31 March 1976 immediately after the close of the month which facilitated review of the progress in collecting deposits every week thereafter. Based on this weekly review, the state government and the banks issued suitable press releases regarding the progress of the campaign from time to time.
- (vii) The state government and state cooperative bank had formulated suitable guidelines for the utilization of deposits, especially in granting loans to the weaker sections of the community. It is understood that although the target of Rs 20 crores had been exceeded by Rs 6 crores in April 1976 itself, the campaign would be continued.

7. Similar campaigns with active support of the state governments and involvement of the cooperative banks may be launched in other states also, which would help substantially to raise the deposit resources of cooperative banks. Further, state governments may remove the disabilities from which the cooperative banks may be suffering on account of administrative instructions or statutory provisions in receiving deposits from local authorities, public corporations and public bodies. It is needless to emphasize again the urgency for extending insurance cover to the deposits with the cooperative banks from the Deposit Insurance Corporation. States which have still not amended the Cooperative Societies Act to facilitate the extension of the Deposit Insurance Corporation Act may do so without any further delay.

V. Issue of Consumption Loans: Procedural and Other Aspects

8. As recommended by the Committee, all the primary agricultural credit societies which are having full-time paid managers/secretaries, the FSS and the LAMPS may issue consumption loans to their members, whether they are agriculturists or not, including agricultural labourers subject to the purpose-wise ceiling indicated by the Committee as under:

a) General consumption	Rs 75@
b) Medical expenses	Rs 250
c) Educational needs	Rs 100
d) Marriage ceremonies	Rs 250
e) Funerals, births, etc.	Rs 75
f) Certain religious ceremonies	Rs 75

Normally, only one person from a family becomes a member of a society. There are, however, cases where more than one person from the same family is a member. Since the by-laws of societies provide for admission of any individual above the age of eighteen, it is possible that husband, wife and adult sons may all become members, particularly when universal membership is stressed, and try to take advantage of the consumption credit facilities known to be envisaged for various purposes. Under the crop loan system, it is not possible for the different members of a family to take a production loan because the same is linked with a given survey number. In the case of agriculturists wishing to take a consumption loan, the society should insist upon their indicating the survey numbers of the lands in the application. In the case of non-agriculturists, the society should insist upon their indicating the number of the house which may have been given for the census purposes or by the gram panchayat. Failure to take these elementary precautions has been responsible for fictitious acreages and over financing under the crop loan system. The consumption credit recommended here is for a family, and proper identification thereof is absolutely necessary to avoid over financing land certain defaults.

(a) *Maximum limit*

13. It is not likely that member would require loans for all these purposes at one point of time. If, however, loans for more than one purpose mentioned above are required, the same may be issued subject to the repaying capacity of a borrower but based on his minimum needs, and also subject to the purpose-wise ceilings mentioned in para 12 above.

14. In terms of para 3 of the Agricultural Credit Department's circular No.ACD.Plan.4458/PR.17-75/6 dated 8 April 1976 loans for consumption purposes may be issued only to the agriculturist members of primary agricultural credit societies, not exceeding 10 per cent of the short-term borrowings or Rs 250/- per member, whichever is less. The Committee, however, felt that this constraint may cause hardship to borrowers whose needs may be genuine and who may have the

@Although this item does not specifically appear in the report of the Committee, yet it has been included here because the Committee has reckoned this item in estimating the credit needs for consumption at Rs 170 crores.

necessary repaying capacity. This has been agreed to by the Reserve Bank and as mentioned in paras 12 and 13 above, loans may be issued for consumption purposes to all members whether they are agriculturists or not, and for all purposes mentioned in para 12, subject to the purpose-wise ceiling recommended by the Committee. The Agricultural Credit Department's circular dated 8 April 1976 is being modified accordingly.

15. The purpose-wise ceiling will not apply to members of primary agricultural credit societies borrowing against the security of gold and silver ornaments. The individual limit in that case will be Rs 1,000/- as indicated in our circular dated 8 April 1976.

(b) Security

16. As for security, the societies may obtain the same type of security as is being provided by the agriculturist-members in respect of their short-term agricultural loans. Thus, if the short-term agricultural loan is issued to a member, either against a charge on land or mortgage of land or against personal security, that is, against promissory note signed by the borrower or one or two other members as sureties, similar security should be obtained for the consumption loans also. Most of the State Cooperative Societies Acts provide for the creation of a first charge on land or other immovable property in favour of a society by the borrowing members by means of a declaration, irrespective of the purpose of the loan. Hence, the society would be in a position to proceed against the land or immovable property for the recovery of the consumption loans also. In cases, however, where an agriculturist-member is issued a loan for the raising of crop or for the purchase of cattle, implements, etc. against personal security as a charge on land or interest in the land cannot be created for some other or the other, the society by virtue of the provisions in the Cooperative Societies Act, will have a prior claim on the crop raised or the cattle, etc. so acquired out the loan as, for example, Section 31 of the Madras Cooperative Societies Act, 1961 which reads as under:

First charge of society: (1) Subject to their prior claim, if any, of the Government in respect of land revenue or any money, recoverable as land revenue, any debt or outstanding demand due to a registered society from any member or past member or the estate of a deceased member shall be a first charge:

- (i) upon the crop or other agricultural produce of such member for the raising of which the loan was taken from the registered society by such member, and
- (ii) upon any cattle, fodder for cattle, agricultural or industrial implements or machinery, or raw materials for manufacture, supplied or purchased in whole or in part out of the loan of money given by the registered society or on any articles manufactured from raw materials so supplied or purchased or on any workshop, godown, or place of business constructed or purchased out of any such loan.

17. It may thus be seen that the society will have no prior claim over the crops or other movable properties if the loan issued to the member is for consumption purpose. It may, therefore, be necessary that the provisions in the Cooperative Societies Act which confer the right of first charge (prior claim) on the society may

be so amended as to cover the loans issued for consumption purposes also. In this connection the provisions of Section 40(1) of the Madhya Pradesh Cooperative Societies Act, 1960, which reads as under are commended for adoption by the state governments with such modifications as are considered necessary:

Notwithstanding anything contained in any law for the time being in force, but subject to any prior claim of the State Government in respect of land revenue or any money recoverable as arrears of land revenue, any debt or outstanding demand owing to a society by any member or past member or deceased member shall be a first charge upon the crops and other movable property belonging to such member, past member or forming part of the estate of the deceased member, as the case may be:

18. In the case of non-agriculturist-members, such as, for instance, agricultural labourers, it may be advisable to issue consumption loans against personal security with at least two if not more members as sureties. In fact, loans may, if possible, be advanced to a group of four or five individuals against their joint and several liability. No other security should be insisted upon in case of agricultural labourers and other weaker sections of the community.

(c) Shareholding

19. A member may be required to purchase shares to the extent of 5 per cent of the loans obtained by him for consumption purposes. In no case, however, the member need subscribe for more than Rs 10 towards share capital in respect of such loans. The deficit in the share capital of the society in raising adequate funds, if any, may be made good by contribution by the state governments out of borrowings from the Reserve Bank's long-term Operations Fund, if necessary.

(d) Rate of Interest

20. As recommended by the Committee, the rate of interest should be the same as charged by the society to its members in respect of its short-term agricultural loans. It is also not advisable to charge lower rates of interest for consumption loans. In cases where the society is charging lower rates of interest on agricultural loans issued to small and economically weak farmers, the normal rate should be charged for the consumption loans issued even to this category of borrowers.

(e) Repayments

21. The consumption loans issued to farmer-members with landholding exceeding 0.5 acre may be recovered along with the short-term agricultural loans, that is, the due dates will be the same and the period not exceeding one year if the quantum of consumption credit is less than 10 per cent of the short-term loan advanced to him. Where the quantum is higher than the above, a longer period up to three years may be allowed, so however that the annual instalment is not less than 10 per cent of his short-term loan. In the case of those with landholding of 0.5 acre or less and non-agriculturist members, it would be preferable to fix a monthly instalment of not less than Rs 10. Where the quantum of consumption credit exceeds Rs 120, for example, in the case of loans for marriages, the period of loan may have to be

longer, but not exceeding three years in any case keeping in view the monthly instalment of Rs 10. It has been recommended by the Committee that this category of borrowers may be covered by the Employment Guarantee Scheme of the state government or some such similar schemes. There should be a link up with the authorities of the scheme for facilitating recovery on a monthly basis.

VI. Refinance from the Higher Financing Agencies

22. The central cooperative banks may reimburse the loans issued by the primary agricultural credit societies for consumption purposes from out of their own resources or from out of the borrowings from the state cooperative bank to the extent possible.

23. The Reserve Bank will treat the finance so provided as a legitimate charge on the central bank's resources and sanction a higher credit limit for short-term agricultural purpose, subject, to, of course the eligibility of the bank for the same.

VII. Share Capital Loan from the Reserve Bank's long-term Operational Fund

24. In light of the recommendations of the Expert Committee on Consumption Credit for strengthening the equity base of primary agricultural credit societies, the following relaxations have been made to the existing terms and conditions governing the grant of loans to the state governments for share capital contribution of such societies.

- (a) Normally, only a society already reorganized on the pattern indicated in the Agricultural Credit Department's letter No.ACD.Plan.5115/PR.55(1)-75/6 dated May 28, 1976 or a viable/potentially viable society having a full-time paid secretary/manager will be eligible for share capital contribution up to Rs 15,000 per society as against Rs 10,000 allowed at present. Loans in excess of Rs 15,000 but not exceeding Rs 50,000 will be considered on the merits of each case, depending on the consumption loans issued and consumers' business undertaken. Where reorganization involves amalgamation or liquidation of the non-viable or dormant societies and such reorganization cannot be brought about before applying to the Reserve Bank for long from the long-term Operations Fund, the Bank will consider applications in respect of the societies identified for retention, provided the societies conform to the pattern indicated in the above circular and the state government gives an undertaking in writing that the other societies within the area of operation of the societies on whose behalf an application has been made, would either be liquidated or amalgamated before the end of the cooperative year in which the loans for contribution to share capital have been availed of.
- (b) Reorganized societies with overdues not exceeding 40 per cent of the outstandings will be eligible for share capital contribution (as against 30 per cent presently allowed). There is, at present, no stipulation regarding the level of overdues for reorganized societies in special programme areas like SFDA etc., for those financed by commercial banks, those organized or reorganized as FSS or LAMPS and those in the States grouped as 'C' by the

Working Group on Cooperation, viz., Assam, Bihar, Meghalaya, Orissa, Rajasthan, West Bengal, Manipur, Tripura and Nagaland.

Farmers Service Societies

25. The existing terms and conditions governing FSS would continue. They will be eligible for share capital contribution up to Rs 50,000 or Rs 1 lakh, each accordingly as the society covers about 10,000 population or the whole block. The contributions already made in respect of the existing societies in their areas would, however, be taken into account in determining the exact amount of the loan for contribution to the share capital of the FSS. The cost of the managing director would have to be met by the sponsoring bank, and of the technical personnel by the state government. The Government should also undertake to amalgamate/liquidate the existing societies in their area of operations within a period of two years. The loan for contribution will be sanctioned, irrespective of the overdues of the FSS.

Large-Sized Multi-Purpose Societies

26. LAMPS organized in tribal areas on the pattern recommended by the Bawa Committee and with a full-time paid manager and other complementary staff will be eligible as hitherto for a share capital loan up to Rs 1 lakh, irrespective of the overdues if the society covers the whole block and Rs 50,000 if it covers 10,000 population. Where the LAMPS has no technical staff of its own, it should be ensured that the services of the extension staff of tribal and other developmental departments of the state government are made available to its members. However, besides the full-time paid manager, the LAMPS should have adequate trained staff for undertaking service functions such as purchase and sale of essential commodities/running of fair price shops and for handling the forest produce of tribal members.

27. Societies in the tribal areas other than LAMPS will be eligible for share capital, irrespective of the level of their overdues on the same basis as in the case of the organized primary agricultural credit societies, viz., Rs 15,000 normally and up to Rs 50,000 on the merits of each case.

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D.O.No.G.8-68

CAMP DELHI
June 22, 1968

My dear I.G.,

You are aware that Shri Manubhai Shah has been thinking in terms of recommending through the Administrative Reforms Commission that certain specialized institutions for financing industry and agriculture, such as the IDBI and ARC should be completely separated from the Reserve Bank and function as wholly independent agencies directly under Government.

I have been giving thought to this proposal as objectively as I can even though I happen to be the Governor of the Reserve Bank, and in that capacity do oversee the working of these institutions.

While the case for such a change would be fully set out in Shri Manubhai Shah's report on the subject, I feel it desirable to set out very briefly the problems and difficulties which I see in such a course. These are:

- (a) To a considerable extent, the resources at the disposal of these institutions are provided by the Reserve Bank. While we can do so in respect of institutions which function more or less as subsidiaries, if they were separated from the Reserve Bank then the channel through which any resources would flow from the RBI to these institutions would be the Central Budget. In other words, we would be making somewhat larger contributions to the Central Budget by way of RBI profits and it would be for the Central Government when presenting the Budget to decide whether and how much should be given to these institutions out of the totality of Centre's resources (including Reserve Bank's contribution) in the light of all other competing claims on them.
- (b) To a considerable extent, these institutions draw upon or supplement the resources which for similar purposes are made available by the banking system. Functioning under the Reserve Bank, they can develop a more coordinated approach in their working and also obtain cooperation from the banks in a fuller measure than would perhaps be possible otherwise. Just at a time when we are gearing banks to do more for agriculture and small-scale industries, if the main agencies for providing finance to agriculture and industry were divorced from the Reserve Bank, the result may not be altogether satisfactory. A considerable proportion of the activities of these institutions relates to refinancing which means that the parties with whom they have their transactions are banks rather than the ultimate beneficiaries. Let me give one or two concrete examples. We are trying to get thousands of bank branches to help industry, particularly small-scale industry, by making term loans with facilities for guaranteeing and refinancing which we provide through the RBI and IDBI. Will this be possible for an independent institution to do so? Similarly, in the agricultural sector, the Agricultural Refinance Corporation has sanctioned over Rs 100 crores of refinance in favour of land mortgage banks. In doing so, the ARC has to form a judgement on the capacity of the land mortgage banks concerned to handle the business. Such a judgement means drawing upon the knowledge which the Reserve Bank through its Agricultural Credit Department has of the regular operations of the land mortgage banks, their managerial capacity and other relevant factors.
- (c) Under the present arrangements, at least a part of the finance being made available to agriculture and industry comes out of credit creation. This can only be done so long as the Reserve Bank retains its present relationship with these institutions. If the IDBI were to become an independent institution, then like the IFC and ICICI, its operations would have to be limited to the real resources at its disposal and it should not undertake any activities which would be in the nature of credit creation.
- (d) The IDBI, in its operations, acts as a leader and coordinator between all the institutions which provide long-term finance, such as the LIC, ICICI and IFC. Every month there are inter-institutional meetings at which, for larger

projects, a consortium approach is adopted so that all the finance needed by way of equity and loans is provided by the different institutions after mutual discussion and agreement. When necessary and appropriate, the State Bank and the scheduled banks also participate in such financing. An institution like the LIC as well as the banks are prepared to accept the IDBI's lead primarily because the RBI has general supervisory role over all financial institutions. It is because the Vice Chairman of IDBI is also a Deputy Governor of the RBI that inter-institutional meetings on such occasions when I am not present are presided over by the Vice Chairman of the IDBI and banks cooperate with the RBI. An IDBI without RBI's backing may not be able to play such a role any more than the IFC was, before the creation of the IDBI.

- (e) Developmental banking, whether in industry or agriculture, has to be aggressive rather than cautious. Yet it is essential that their operations should not disregard the safety of the loans made. Experience has shown that all too often financial institutions set up to help industry or agriculture find themselves in difficulties because they have made a large number of irrecoverable loans. So many cooperatives have run into difficulties because they have disregarded sound banking principles. The Reserve Bank being a non-political body is in a better position to apply restraint, where necessary, than an institution outside the banking field would be. This danger would be accentuated if it were to happen that such institutions were placed under the Ministries concerned with development rather than with Finance.
- (f) Finally, there is the consideration that all these institutions are going concerns. They have made sizable loans and they are in the process of considering others. A major reorganization which would call for fresh legislation and involve transfer of staff, accounts, etc. would inevitably mean a temporary standstill in the process of making and recovering loans. I doubt whether the impact of such a change on the economy which is enough problem today, would be a healthy one.

As the issues relate to the scope of activities of the Reserve Bank itself, I feel that it would be better if you rather than I discussed the problem in all its aspects with D.P.M. and indicated to me the lines on which he feels we should proceed.

Yours sincerely,

L.K. JHA

Dr I.G. Patel
 Special Secretary
 Department of Economic Affairs
 Ministry of Finance
 Government of India
 New Delhi

D.O.No.G.8

BOMBAY
July 3, 1968

My dear Manubhai,

Thank you very much for sending me copies of your draft report. As already agreed, we shall meet and discuss on 9th July, and I suggest 11 in the morning for the purpose if it is convenient to you. You also told me that you would be here on Saturday, the 6th and would like to have some discussions on that day too. Damry will have returned from Hyderabad on the 5th evening; so I suggest you could meet him on the 6th morning—again at 11 a.m. if it suits you. Pendharkar will also be available for any discussions that you may wish to have with him. On Monday, the 8th you could meet Adarkar, Baksi and Anjaria. If points of detail have been covered in this manner, we could discuss the report as a whole on the 9th morning.

Meanwhile, I thought it might be useful if I wrote to you offering my comments on one basic issue, viz., whether the Reserve Bank should confine itself to the traditional central banking functions or whether it should continue with its developmental functions as well. It is only after one's sense of direction on this fundamental point is clear that the rest of the recommendations in the draft report can be considered and discussed.

In paragraphs 14 and 15 of the report, the view has been expressed that the Reserve Bank of India being entrusted with developmental work was a 'historical accident' and that this was partly due to 'the British Government not being interested in the development of the country'. Factually, it is only after independence and nationalization that the Reserve Bank of India began to be seriously involved in developmental work. No doubt, following the report of the Banking Commission which had recommended the setting up of the Reserve Bank of India, it had been entrusted with some special responsibilities in respect of cooperatives and agriculture from its very inception. But the Agricultural Refinance Corporation, the IDBI and indeed all that the RBI does for development are very much the result of deliberate policy decisions in the years after independence. The IDBI was set up as a subsidiary of RBI only four years ago, despite the fact that the IFC and the ICICI both had been in existence for many years before. The changes proposed in the draft report should, I suggest, be put forward, if they are to be put forward, not on the ground of rectifying a legacy of foreign rule or an inadvertent slip, but on the judgement that the previous decisions were unsound.

You have referred to the practice followed in a number of countries. Certainly in many of them, central banks do not undertake developmental activities. These are countries whose development has taken place over more than a century, who have not had to face the kind of problems which we are facing, and who have not had recourse to planning as an instrument of development. The example of England, USA, France and Japan is therefore not necessarily valid for us. However, I would point out that the Bank of England had the Bankers' Industrial Development Company which was set up after World War I as its subsidiary. The example of the Soviet Union or Hungary can hardly help us because they have no problem of

providing finance for the private sector. On the other hand, if we look at Canada and Australia, we find a different picture. Not only was the I.D.B. in Canada set up as a subsidiary of the Bank of Canada—a model which we followed—but the Royal Commission on Banking a few years ago came out solidly in favour of continuing this arrangement. Canada, as you know, had been trying to industrialize its vast agricultural hinterland and to build up industries which, by American standards, fall into the group of small and medium industries. This is the main task of IDB in Canada. In Australia, the Commonwealth Bank initially undertook developmental functions as well. This position was changed in 1959 not because the system did not work well but because of political reasons. Even so, the Reserve Bank of Australia continues to deal with agriculture directly. In Brazil, central banking and agricultural and industrial credits are handled by the Banco de Brazil. In Italy, the IMI from 1931 to 1948 was very much under the Bank of Italy, the Governor of the latter being Chairman of the former. In fact, it would not be an exaggeration to say that the concept of the Central Bank keeping away from development is a nineteenth-century *laissez-faire* idea.

However, it is not by looking at what other countries are doing that we can really solve our problems. The main reasons why you seem to favour a change in our set-up seem to be the following:

- a) Involvement in development distracts from the main functions of the RBI as a Central Bank which are therefore neglected.
- b) As independent institutions, these agencies will be far more successful in fulfilling the tasks assigned to them.

So far as the first point is concerned, I should like to say quite categorically that whether the RBI discharges its functions well or poorly is in no way affected by the links which the RBI has with developmental work connected with IDBI or ARC. Both these institutions have their own staff and function as autonomous organizations. The people who look after management of the Public Debt or foreign exchange control do not have any occasion to devote any time to work connected with agricultural or industrial development. On the operational plane, the links between the developmental agencies under the RBI and the rest of the RBI staff boil down to only two things. Firstly, for filling their posts, they do frequently draw upon the RBI staff which has a good deal of experience of a kind which they need and which would not be available in the open market. Secondly, if and when occasions do arise for consultations, these can be done quickly and informally. For example, if the IDBI receives a request for financing an export on deferred payment, it can make a quick check from the Exchange Control Department whether deferred payment facilities have, in that case, been approved or would be approved. Similarly, when a commercial bank wants to open a branch in a rural area, the Department of Banking Operations and Development can make a quick informal check with the ACD to find out whether cooperative interests were likely to be adversely affected by it.

The point has been made (para 16.2) that the board of directors of a developmental organization should consist mainly of the representatives of interests it seeks to serve. So far as the ARC is concerned, it has an independent board of the

type that you have described. It is only the IDBI which has the same board as the RBI. Now unless it is the intention to provide the IDBI with the kind of board which the ICICI has, viz., a board consisting of industrialists only, I doubt if the view could be sustained that the IDBI, on its own, would have a better board than it has today. On the RBI Board, there are always some of the foremost industrialists in the country as well as some of the smaller industrialists; in addition, there are persons of eminence in law, economics, accounting and public life. Then again, the IDBI in its actual operations and in examining new loan applications, does bring in other experts into the picture. I am not clear, therefore, as to what are the elements not represented on the RBI which should be on the IDBI, or which are on the RBI but should not be on the IDBI.

A point has been repeatedly made in the draft that it is desirable to sever the links between the RBI and developmental agencies so that what they do can be freely discussed and debated in public and in Parliament. I do not see any basis for the assumption that bodies like the IDBI and ARC are immune from criticism because they operate under the shelter of RBI. The credit policy followed by the RBI itself is a matter which is open to public debate, and in fact the Press makes frequent references to it. There have been references in Parliament also. Similarly, credit policy for agriculture and cooperatives has been discussed in various forums including meetings of State Chief Ministers presided over by the Union Minister for Food, Agriculture and Cooperation. If public criticism of the working of IDBI and ARC has not been vociferous, could it not be that this is because these institutions have followed sound objective criteria, and because it is recognized that they are not subject to political influence?

One of the major objections which I see to the pattern of reorganization outlined in the draft report is that not only does it mean a reversal of policy decisions taken four or five years ago, but it also means a reversal of certain major decisions taken in the last few months. We are just now engaged in making the entire banking system reorientate itself towards lending more on agriculture, to small-scale industries and exports. This lending incidentally has to be both short-term and medium-term. To achieve this, the boards of major banks have been reorganized, the National Credit Council has been created and the whole machinery of what is known as social control is being provided for, by the proposed amendments to the relevant acts. If now wholly new institutions are to be set up to look after agriculture, small-scale industries and exports respectively, then all this effort at reorganization will have been so much waste of time.

I am not one of those people who feel that if a mistake has been made, we should not own it up and rectify it. The crucial question to consider is whether the kind of reorganization which is being suggested will really help the people for whose benefit they are meant. I personally think it won't and I have set out below briefly the main reasons why I say so:

(a) Large-Scale Industry:

Experience has shown that for financing any large-scale project, it is necessary to secure the assistance not of one single institution but of a number of them. Thus,

the IDBI works in close conjunction with the LIC, IFC and the ICICI as well as the commercial banks who also take a share in underwriting and in providing short- and medium-term finance.

The link between the IDBI and the RBI certainly helps in securing a coordinated approach among so many institutions, each fully independent of the other but each prepared to treat the Governor of the Reserve Bank as someone whose leadership they should accept. An independent IDBI will be no more effective in this than the IFC was before IDBI was created.

(b) Small-Scale Industry:

Their credit needs cannot be met by one central institution located in Delhi or even by branches in other State capitals. They need a decentralized approach. The banking system with thousands of branches all over the country including semi-urban areas is much more accessible to the genuine small-scale industrialists, and therefore the system that we have built up of involving the banking system in this task by giving them guarantees through our IFD and refinancing through IDBI is, to my mind, a better answer to the problem than the alternative now being put forward.

(c) Agriculture:

In regard to financing agriculture through cooperatives, one of the weaknesses today is that while the RBI deals with the apex body in each State, there are two other tiers between the apex body and the ultimate borrower. The result is that although the RBI gives money to the apex body for various purposes at 2 per cent below the bank rate, the ultimate rate which the borrower pays to a cooperative is higher than the maximum rates charged by commercial banks to their clients. This is because at each tier a margin has to be kept to take care of the cost of administration and the risk involved. If an all-India body were to be interposed so that there are 4 tiers instead of 3, then whatever else may happen, the lending rate to the ultimate borrower will go up by 1½ to 2 per cent, which will be the all-India body's margin. If you discuss the problem with someone like Prof. Gadgil who has direct experience of this, you will probably come to the conclusion that the alternative you have suggested will create more difficulties than it will solve.

In regard to the ARC, again its links with the ACD are vital and should not be disrupted. In fact, the real problem on the ARC front, as your report itself brings out, is that while large sums have been sanctioned, very little has been disbursed. This clearly calls for a study of the operational arrangements at the State level which hold up implementation of schemes and delay disbursements. If the ARC had been slow in sanctions, I would have been the first to concede the need to have a second look at it.

(d) Exports:

The financing of exports broadly has two aspects. On the one hand, there is the problem of credit to help manufacturers produce for exports, and on the other, to tide over the period which must elapse before they receive full payment from their buyers abroad. This, in my view, is best done by the banking system. The

manufacturer's bank would know its overall working, be providing it with finance for other purposes as well, and would have a lien on much of its assets. For another agency to be relied upon for this purpose would mean a fresh investigation of the manufacturer's affairs and financial position, conflict of claims in regard to lien and other similar problems. Countries which have got specialized agencies for financing exports like the Export-Import bank undertake, in the main, the responsibility for financing the buyer abroad. This is quite a different operation. The normal line of division is that for credits of a type which banks can provide, bank money continues to be deployed with appropriate guarantees to cover export risks. When, however, it is a question of making long-term credit available or of putting funds at the disposal of a buying country to buy whatever it wants, then another agency comes into play. This other agency can be the Government itself. This is our practice also when we make Government to Government loans available. On the other hand, in some countries there are special institutions which make such loans usually in addition to the loans at Government level. The question whether a separate Export bank is headed by India has to be considered in the light of whether we feel that the time has come when, in addition to Government to Government credits, we also need an institution to extend credits of this kind. However, to disturb the existing arrangements for financing the exporter to produce, pack and ship will, to my mind, do more harm than good.

I am sorry this letter has already become longer than I had intended it to be. Let me conclude. The economy is just beginning to emerge from a most disappointing and sterile phase. At this juncture, to think of radical changes in the very institutions that have sustained it in these difficult years may well have many adverse repercussions. These institutions, when they come into being, will probably spend a year or so in getting organized, finding office space, staff and other similar activities. One of the advantages of the present arrangement is that private savings as well as such credit as the Reserve Bank creates, do go to provide additional resources for the institutions and agencies under discussion. However, if wholly new institutions of the kind envisaged were brought into being and their main reliance for resources were through debentures, then all that would happen is that the money which certain institutions are required to invest in trustee securities will come to these bodies, and to that extent institutional support for Central and State loans will be undermined.

I hope you will think over what I have said above so that when we meet, we can jointly address ourselves to the basic issue of accelerating development in which I am as much interested as you are.

Shri Manubhai Shah

Yours sincerely,
L.K. JHA

January 5, 1972

My dear I.G.,

I have been giving continuous thought to the question of the Unit Trust and the new Chairman that we have to find.

2. I appreciate that it is necessary to put forward several names, since some of them may not be acceptable to Government. I have, however, deliberately not eliminated any names (of which I was doubtful about their acceptability) since I wish to indicate the full range of possibles as I see them, and also explain the process of thinking that leads me to suggest these names.

3. The position of the Chairman, Unit Trust has, during the greater period of R.S. Bhatt's tenure been equated to a Deputy Governor of the Reserve Bank, carrying a salary of Rs 3,500/- (with no free house or house allowance). However, during R.S. Bhatt's first year he got something less. A starting pay of Rs 3,125 in the scale of Rs 3,000-125-3,250. We could consider this post as something approximating, from the point of view of pay only, to that of a Secretary to Government, but it could also be filled on the scale of Rs 3,000-100-3,500 or Rs 3,000-125-3,250 or Rs 3,250-125-3,500, if need be, to fit the selected person.

4. In addition to adequate standing, good general ability and, most important, complete integrity with a reputation for such, which are all obviously necessary qualities, I consider it highly desirable that the person selected should have professional expertise, or at least a degree of professional familiarity with the field in which he will have to function. Against this background, I cite four names below, with some comments.

(1) *Shri J.S. Raj*

My first name is/continues to be, J.S. Raj. He has been in Government service from about 1941 and until 1970. He has functioned in the public sector whenever he was not in direct Government service, in the Ministry of Agriculture, in the Stock Exchange wing of the Department of Economic Affairs (Additional Director, Stock Exchange) or working as our Director on the IMF. For long periods, he has held senior positions in what I call public institutions, that is, he was Director of the Asian Department of the IMF for many years, and more recently Vice-President of the International Finance Corporation, which, of course, is an affiliate of the World Bank. He is an economist with education in London and had done teaching in Rangoon University. He has acquired valuable acquaintance with Indian industry as Deputy General Manager of the ICICI (which is now owned for the major part by our financial institutions, LIC, banks, insurance companies that have been now taken over by Government, etc.). He was also, for some time, General Manager of the Nigerian Industrial Development Bank, as an employee of the World Bank.

In nationalized banks, in the nationalized LIC and in our recently taken over general insurance companies, we have been careful to retain men of professional standing and ability as the heads, and therefore we have kept on many of those who

were Chairmen of large Indian banks before nationalization, and the senior executives of the life companies that merged and became the LIC, and more recently executives of the general insurance companies that have been taken over, when the men concerned are believed to be both able and honest. (I would like to cite Trikha, B.K. Dutt of banks and B.K. Shah of insurance.) I do feel that for our leading investment institution, the Unit Trust, it would not be incorrect in any way to apply similar criteria, that is we should value professional skill, experience and standing, and we should not count any period of service in a private company against the individual, especially if that has helped the individual in a unique way to acquire experience and skill in the particular field (banking, insurance or investment, as the case may be), and the person concerned has a good reputation. R.S. Bhatt was himself in the Oriental Life Insurance, in its Investment Department, a long time ago. This experience stood him in very good stead. J.S. Raj has been in the private sector, in the ordinary sense of the word, only after his return to India in the middle of 1970, when he became the head of a small investment corporation. Such experience as he has been acquiring in this is not only not misplaced but an addition to such acquaintance with Indian industry as he acquired in the ICICI and in the International Finance Corporation, as also during his period in the Finance Ministry's Stock Exchange wing.

(2) Shri A. Rajagopalan

The most obvious source to look for a person with the requisite experience would, after the Unit Trust itself (which cannot just yet provide a suitable chairman) be the LIC. There have been several Managing Directors of the LIC who have recently retired. Leaving out of account a possible name on the wrong side of 62, I would say, an eminently suitable person would be A. Rajagopalan, Additional Secretary in the Department of Insurance, who was the Managing Director of the LIC for a period and later in Ceylon advising the Ceylon Government on insurance, especially on problems of nationalization. He is a capable man well-known to you and to F.M. He is presently handling not only the LIC but also the general insurance companies that have been taken over by Government as a prelude to nationalization.

(3) Shri P.D. Kasbekar

I may briefly mention that while the Reserve Bank has a few people of ability and standing, it does not have any one (after Pendharkar) with any special proficiency or detailed acquaintance with the particular field (and none that I would suggest for being placed above the Executive Trustee from the Reserve Bank, Shri S.D. Deshmukh). I would like to pass on to discuss the possibilities from Government.

But first I would mention about P.D. Kasbekar. He is a senior Joint Secretary who handles not only capital issues but also matters relating to investment policies of the LIC and the Unit Trust. He has picked up a sound knowledge of Company Law and the working of the Company Law Department. He has the requisite personal qualities as well and would make a good choice.

(4) Shri K.S. Raghupathi

Apart from Kasbekar, I am not able to think of anyone whose work has directly touched on questions of investment. There are quite a few able senior officers in Government with a financial background, whom you will be able to think of. I shall be content with naming Raghupathi, now in the Ministry of Foreign Trade, a senior Joint Secretary (or possibly he has become Additional Secretary recently). He was in the Department of Iron and Steel when the first three public sector steel plants were erected and commissioned. He was our Economic Minister in London for quite a number of years and has fairly good general acquaintance with the field of banking, investment and company affairs. You may be able to think of one or two other suitable names.

(5) and (6)

There are two other names, viz. (5) Dr B.K. Madan, who was Deputy Governor, Reserve Bank of India and Vice-Chairman, IDBI and then retired as our Executive Director on the IMF; and (6) K.P. Mathrani who retired recently as Secretary, Ministry of Food and was previously not merely Secretary, Finance in undivided Bombay but also Additional Secretary in-charge of banking and 'internal finance' in the Department of Economic Affairs at Delhi and later Chairman, IFC. The last two are eminently suitable, and I put them last in my list only because I believe they have recently crossed their sixtieth birthday, being therefore only a couple of years or so younger than R.S. Bhatt.

I shall telephone you after you have had a chance to see this letter. I apologize for the length of this letter.

With kind regards,

Dr I.G. Patel
Secretary
Government of India
Ministry of Finance
Department of Economic Affairs
New Delhi

Yours sincerely,
S. JAGANNATHAN

76

JOINT COMMITTEE ON THE PUBLIC FINANCIAL INSTITUTIONS LAWS (AMENDMENT) BILL, 1973
COMPOSITION OF THE COMMITTEE

Shri B.N. Kureel, Chairman

*Members**Lok Sabha*

2. Shri Dinen Bhattacharya
3. Shri Chandulal Chandrakar
4. Shri K. Chikkalingiah
5. Chaudhry Dalip Singh

6. Shri Anadi Charan Das
- †7. Shri B.K. Daschowdhury
8. Shri C.T. Dhandapani
9. Shri Jambuwant Dhote
10. Shri Jagdish Chandra Dixit
11. Shri Devinder Singh Garcha
12. Shri Indrajit Gupta
13. Shri Noorul Huda
14. Shri Ramachandran Kadannappalli
15. Shri Robin Kakoti
16. Shri N.S. Kamble
17. Shri Madhu Limaye
- *18. Shri K.M. Madhukar
- †19. Shri Vikram Mahajan
20. Shri Jagannath Mishra
21. Shri Shrikishan Modi
22. Shri Pилоo Mody
23. Shri Surendra Mohanty
24. Shri Pratap Singh Negi
25. Shri Rajaram Dadasaheb Nimbalkar
26. Dr Laxminarayan Pandeya
27. Shri E.V. Vikhe Patil
28. Shri M.S. Purty
29. Ch. Ram Prakash
30. Shri Ram Swarup
31. Shri M.S. Sanjeevi Rao
32. Shri M.Ram Gopal Reddy
33. Dr Govind Das Richariya
34. Shri Babu Nath Singh
35. Shri Somchand Solanki
36. Shri K. Suryanarayana
37. Shri T.V. Chandrashekarappa Veerabasappa
38. Shri N.R. Vekaria
39. Shri Sukhdeo Prasad Verma
- % 40. Shri C. Subramaniam

Rajya Sabha

41. Shri K.B. Chettri
42. Shri Babubhai M. Chinai
43. Shri Bhupesh Gupta
44. Shri Yashpal Kapur

†Appointed w.e.f. 20.11.1974 vice Sarvashri K.R. Ganesh and A.K.M. Ishaque resigned.

*Appointed w.e.f. 30.8.1974 vice Shrimati Roza Vidyadhar Deshpande resigned.

%Appointed w.e.f. 20.11.1974 vice Y.B. Chavan resigned.

45. Shri M.S. Abdul Khader
46. Shri B.V. Abdulla Koya
47. Shri A.G. Kulkarni
48. Shrimati Sumitra G. Kulkari
49. Dr K. Mathew Kurian
50. Shri B.N. Mandal
51. Shri Rishi Kumar Mishra
52. Shri Lokanath Misra
53. Shri Deorao S. Patil
54. Shrimati Saraswati Pradhan
55. Shri S. Ranganathan
56. Shri R. Narasimha Reddy
57. Shri Kameshwar Singh
58. Shrimati Maimoona Sultan
59. Shri Subramanian Swamy
60. Shri Gian Chand Totu

Legislative Council

1. Shri S.K. Maitra, *Joint Secretary and Legislative Council*
2. Shri N.L. Vaidyanathan, *Additional Legislative Council*

Representatives of the Ministry of Finance (Department of Banking)

1. Shri M.G. Balasubramanian, *Additional Secretary*
2. Shri M.K. Venkatachalam, *Joint Secretary*
3. Shri V.K. Shunglu, *Deputy Secretary*
4. Shrimati Nalini M.K. Menon, *Deputy Secretary*

Secretariat

1. Shri P.K. Patnaik, *Additional Secretary*
2. Shri Y. Sahai, *Chief Legislative Committee Officer*

Report of the Joint Committee

I, the Chairman of the Joint Committee to which the Bill* further to amend the Industrial Development Bank of India Act, 1964, the Reserve Bank of India Act, 1934, the Industrial Finance Corporation Act, 1948, the State Financial Corporation Act, 1951, the Life Insurance Corporation Act, 1956 and the Unit Trust of India Act, 1963 was referred, having been authorized to submit the report on their behalf, present their report with the Bill, as amended by the Committee annexed thereto.

2. The Bill was introduced in Lok Sabha on 22nd December, 1973. A motion for suspension of the first proviso to Rule 74 of the Rules of Procedure and Conduct of

*Published in the Gazette of India, Extraordinary, Part II, Section 2, dated 22nd December, 1973.

Business in Lok Sabha in its application to the motion for reference of the Bill to a Joint Committee of the Houses was moved in Lok Sabha by Shri K.R. Ganesh, the then Minister of State in the Ministry of Finance on 25th March, 1974 and was adopted.

Thereafter, the motion for reference of the Bill to a Joint Committee of the Houses was moved in Lok Sabha by Shri K.R. Ganesh, the then Minister of State in the Ministry of Finance on the same day and was adopted (Appendix I).

3. Rajya Sabha concurred in the said motion on 11th May, 1974 (Appendix II).

4. The message from the Rajya Sabha was published in Lok Sabha Bulletin – Part II, dated 13th May, 1974.

5. The Committee held 23 sittings in all.

6. The first sitting of the Committee was held on 6th June, 1974 to draw up their programme of work. The Committee decided to invite memoranda from all State Governments, leading Chambers of Commerce and Industry, Public Financial Institutions, Employees Associations of Public Financial Institutions, eminent economists and cooperative organizations interested in the subject matter of the Bill and also decided to issue a Press Communiqué on its behalf fixing 10th July, 1974 as the last date for receipt of memoranda. The Committee also decided to take oral evidence of the representatives of some of the associations, individuals, etc.

7. 25 memoranda on the Bill were received by the Committee from various associations, organizations, etc. (Appendix III)

8. The Committee heard oral evidence given by the representatives of various associations, organizations, etc. at their sittings held from 15th to 17th July, 25th to 27th September, 21st to 23rd October 1974, and 5th to 7th February and 16th April 1975. (Appendix IV)

9. At their sitting held on 10th June 1975, the Committee decided that (i) the evidence tendered before them might be laid on the Table of both the Houses; and (ii) two copies each of memoranda received by the Committee from various associations, organizations, etc. might be placed in the Parliament Library after the report of the Committee was presented, for reference by the Members of the Parliament.

10. The Report of the Committee was to be presented by 26th July, 1974. The Committee were granted extension of time twice—the first extension on 23rd July, 1974 was up to 21st February, 1975, and the second extension on 19th February, 1975 was up to 28th July, 1975.

11. At their sittings held on 9th and 10th June, 1975 the Committee held general discussion on the various points raised in the memoranda submitted to the Committee, and also during the course of evidence tendered before the Committee.

12. The Committee considered the Bill clause-by-clause at their sittings held on 19th and 20th June and 11th July, 1975.

13. The Committee considered and adopted their Report on 19th July, 1975.

14. The observations of Committee with regard to the principal changes proposed in the Bill are detailed in the succeeding paragraphs.

15. *Clause 2:* The Committee are of the view that the Industrial Development

Bank of India which would be the principal financial institution in the country and the other financial institutions should deploy their resources in accordance with national priorities.

Clause 2 has been amended accordingly.

16. *Clauses 5: 19: 20: 39: [Original clause 37]; 48: [Original clause 44]; 56 [Original clause 51]; and 58 [Original clause 53].* The amendments made are of a formal nature, being consequential to the change of the year.

17. *Clause 7:* (i) The amendment made in Paragraph (c) of sub-section (1) of proposed section 6 is of a consequential nature.

(ii) New section 6 (1) (c) (iii): The Committee are of the opinion that two directors of the Development Bank should be from amongst the employees of the Development Bank and the financial institutions. Out of these directors, one shall be selected from amongst the office employees, and the other shall be selected from amongst the workmen, and such selection shall be made in the manner prescribed by the Central Government.

New section 6 (1) (c) (iii) has been inserted accordingly.

(iii) Proposed new section 6(1) (c) (v): The Committee are of the view that for the words 'practical experience', the words 'professional experience' may be substituted.

The Committee are also of the view that special knowledge of, and the professional experience in, 'marketing' should also be one of the qualifications for eligibility for being nominated as members of the Board of Directors of the Development Bank.

Proposed new section 6(1) (c) (v) has been amended accordingly.

18. *Clause 17:* The amendments made are of a verbal nature.

19. *New Clause 21:* The Committee are of the view that the Industrial Finance Corporation Act, 1948 might also extend to Kohima and Mokokchung districts in the State of Nagaland from such date as the Central Government may, by notification in the Official Gazette, appoint.

New Clause 21 has been inserted accordingly.

20. *Clause 22 (Original clause 21):* The amendment made is of a drafting nature.

21. *New Clause 23:* The Committee on Subordinate Legislation of Lok Sabha have recommended that rules and regulations made under various enactments should statutorily be published in the official Gazette.

The Committee on Subordinate Legislation of both Houses of Parliament have also approved a revised model clause for the laying, before Parliament, of rules, etc. made by the Central Government under Central Acts.

New clause 23 has been inserted with a view to amending section 42 of the Institutional Finance Corporation Act, 1948 in order to give effect to the above recommendations of the Committee on Subordinate Legislation.

22. *New clauses 41 and 53:* New clauses 41 and 53 seek to insert new section 6A in the Life Insurance Corporation Act, 1956 and new section 19A in the Unit Trust of India Act, 1963, respectively. Both the sections seek to empower the Corporation or the Unit to impose conditions necessary to protect their interests, and for ensuring that the accommodations granted by them are put to the best use by the concerns

to which such accommodation had been granted. Further, they provide that where any arrangement is entered into by the Corporation or the Unit Trust with any assisted concern providing for the appointment by either of them, of one or more directors, the provisions of the Companies Act, 1956, or of any other law shall not apply to such director, and that such director shall hold office during the pleasure of the Corporation or the Unit Trust, as the case may be, nominating him and shall not incur any liability for anything done or omitted to be done in good faith in the discharge of his duties as a director and shall not also be liable to retire by rotation. Since the role of the nominated directors is quite different from that of the elected directors, it is necessary to extent the aforesaid legal protections to the nominated directors so that they may function properly as directors of the assisted concerns.

The Committee notes that provisions similar to these provisions already exist in the Industrial Development Bank of India Act, 1964, the Industrial Finance Corporation Act, 1948, and the State Financial Corporations Act, 1951, and as such, there is no objection, in principle, to the insertion of the proposed new sections.

Accordingly, new section 6A has been inserted in the Life Insurance Corporation Act, 1956, and new section 19A has been inserted in the Unit Trust of India Act, 1963.

23. *New clause 43:* The Committee on Subordinate Legislation of both Houses of Parliament have approved a revised model clause for the laying, before Parliament, of rules, etc. made by the Central Government under Central Acts. This clause has been inserted with a view to bring section 48 in line with the revised model clause approved by the above-mentioned Committees.

24. *Clause 1 and Enacting Formula:* The amendments made are of a formal nature.

25. The Committee recommend that the Bill, as amended, be passed.

New Delhi
July 25, 1975
Sravana 3, 1897 (*Saka*)

B.N. QUREEL
CHAIRMAN
JOINT COMMITTEE

MINUTES OF DISSENT

I

The Public Financial Institutions Laws (Amendment) Bill 1973, as approved by the majority of the Joint Committee, is a retrograde piece of legislation. The proposal to delink Industrial Development Bank of India, Unit Trust of India, Industrial Finance Corporation of India and State Financial Corporations from the Reserve Bank of India, and to convert the Industrial Development Bank of India as an apex financial institution, separated from the Reserve Bank of India and functioning as a parallel institution under the administrative control of the Ministry of Finance, Department of Banking, will destroy the very foundations of the credit structure which has been built up during the last two decades.

The main objective of the Bill is to 'restructure the Industrial Development Bank of India in certain respects, so as to enlarge its role as the principal financial institution financing industry and for coordinating the working of other financial

institutions engaged in the financing or promotion or development of industry.' It is our contention that the Bill, as amended and approved by the Joint Committee, will fail miserably in achieving the above objective. In fact, the contents of the Bill have very little relation to the actual provisions in the Bill. The statement of objectives, thus, remain as a statement of pious wishes, totally irrelevant to the actual provisions in the Bill. We are surprised to note that the Bill has been approved by the majority in the Committee, rejecting the very weighty and valuable arguments put forward by experts during the tendering of evidence before the Committee. The evidence before the Committee very clearly indicate that the Bill has been misconceived, and should therefore be scrapped. The evidence further indicates that there is no valid economic or administrative reason for delinking the Industrial Development Bank of India from the Reserve Bank of India.

The reconstitution of the Industrial Development Bank of India, as proposed in the Bill, will not improve operational efficiency of the Industrial Development Bank of India; nor will it create better machinery for developmental financing, better coordination of credit operation, etc. The Industrial Development Bank of India, from its very inception in 1964, was expected to function as 'The principal financial institution for coordinating the working of institutions engaged in financing, promoting or developing industry for assisting the development of such institutions.' This characterization of the functions of the Industrial Development Bank of India is nothing new. For, as stated by the then Finance Minister, the late Shri T.T. Krishnamachari, while moving the Industrial Development Bank of India Bill in 1964:

'We are envisaging the new Industrial Development Bank of India as the Central Coordinating Agency which ultimately will be concerned directly or indirectly with all the problems and questions relating to the long- and medium-term financing of industry.'

The organizational changes proposed in the Bill will introduce dichotomy in the credit structure, between long-term lending and short-term finance. At present, coordination between long-term lending and short-term credit is attempted to be brought about by the unified control exercised by the Reserve Bank of India, which is really the apex of all financial institutions, ensuring the desired integration in the credit structure.

It is generally accepted principle that, in a developing economy the Central Bank should perform not only the traditional role of banker to the bankers, but also perform the developmental and promotional role in the field of long-term lending. It is this principle which is being negated by the present Bill.

The Reserve Bank of India has, during the last two decades, initiated steps in promoting both industrial and agricultural finance. The operations of the Reserve Bank are not without blemish. The point at issue, however, is that the decision to integrate short-term and long-term finance under guidance of the Central Bank, that is, the Reserve Bank of India, was a step in the right direction and consistent with the modern notion of Central banking in the context of a developing economy.

The protagonists of the present Bill seem to argue that, though the Reserve Bank of India performed a useful role in the promotion of industrial finance in the past,

a stage has now come when industrial financing function should be separated from the Reserve Bank of India. This argument implies that developmental finance is not a core function of the Reserve Bank of India, and that they were given the extra responsibilities for nursing a child which has now become adult. The analogy is that industrial finance should now be left free to grow as an independent entity. As pointed out earlier, this argument is a distorted one and negates the fundamental principle that there should be no dichotomy between short-term credit and long-term lending and that the Central Bank, particularly of a developing country, should play the crucial role of integration and coordinating both these areas of financing.

The Industrial Development Bank of India was set up in 1964 as a wholly owned subsidiary of the Reserve Bank of India. The Industrial Development Bank of India was to function as the apex of an integrated structure of industrial finance, and to provide resources for industrial projects of large size which could not be catered to by the then existing agencies and institutions. Apart from extending medium- and long-term finance in the form of direct deployment of funds to industrial units, the Industrial Development Bank of India was also to give refinance facilities to the commercial banks and State Financial Corporations.

It is important to note that a number of institutions were set up during the last two decades of India for meeting the requirements of short-term credit for trade and commerce, medium- and long-term investment finance for industry, as well as short-, medium- and long-term finance for agricultural operations. In the creation of these specialized institutions and in guiding them, the Reserve Bank of India has played a vital role. The direct and indirect control, assistance and guidance of the Reserve Bank has been helpful in ensuring a certain degree of coordination and integration of the functions of these specialized institutions.

Even after the present Bill is passed, agricultural finance will continue to remain with the Reserve Bank. Thus, under the new dispensation, the Reserve Bank of India will continue to perform the developmental function in the field of agricultural finance, but will have very little role in the field of industrial finance. This will surely be disastrous to a proper development of the credit infrastructure in the country, apart from the fact that it implies an asymmetry which is irrational and illogical.

The present Bill will introduce a situation where the benefit of professional management under the control and guidance of the Reserve Bank of India will be denied to the IDBI. This will also be contrary to the intention of the farmers of the original IDBI Bill in 1964. To quote the Finance Minister who moved the Bill in the Rajya Sabha in 1964:

‘In view of its close association with the Central Bank of the country, the IDBI will be able to draw on the knowledge and experience of that Bank and to obtain in its day-to-day operations, such guidance and assistance as may be necessary.’

The IDBI was constituted as a subsidiary of the Reserve Bank of India in consonance with the widely accepted principle that the Central Bank of a developing country should assume special responsibility for the promotion of a sound investment banking structure. Explaining the rationale for making IDBI a fully

owned subsidiary of the Reserve Bank of India, the then Finance Minister, the late Shri T.T. Krishnamachari stated in the Lok Sabha thus:

‘The House will appreciate that the responsibilities which are proposed to be entrusted to the institution will be onerous and heavy. It is, in a sense, a lender of the last resort for all periods other than purely short-term periods, and for all or practically all purposes, as far as industrial enterprises are concerned. We have considered it desirable in those circumstances, to provide for the ownership and management of the new institution being vested in the Reserve Bank of India.’

Apart from the above theoretical and fundamental considerations, there are several practical advantages in continuing the present arrangement, that is, the IDBI continuing as a fully owned subsidiary of the Reserve Bank. Mention has already been made to the availability of the fund of professional management and financial expertise which the Reserve Bank possesses and which will flow to the IDBI as a matter of course. Another distinct advantage arises from the financial dependence of the IDBI on the Reserve Bank. To quote the Annual Report of IDBI for the year 1971–72:

‘As a result of the discontinuance by the Government of the flow of funds to the IDBI since 1969–70, the main sources of funds for the IDBI in the last three years have been (i) repayment of instalments by borrowers, (ii) borrowings from the Reserve Bank of India out of the National Industrial Credit (Long-Term Operations). Fund and increase in paid-up capital, which is wholly contributed by that Bank. Borrowings from the LTO Fund have been on an increasing scale during the last three years.’

Against these distinct advantages, the new Bill gives the definite impression of a futile institutional change. By delinking the IDBI from the Reserve Bank, neither the volume of credit to industry will increase nor will the cost of credit decrease. Thus, there is no economic rationale for the Bill.

The evidence given before the Joint Committee show that certain large industrial houses such as Tatas and Modis had taken interest in the proposal for delinking of IDBI from the Reserve Bank of India, and that Shri Palkhivala had also suggested such a proposal.

The implication is very clear. Some of the monopoly houses feel that the ‘relative’ independence of the Reserve Bank of India, and therefore of the IDBI, is an impediment in the free flow of financial resources to the coffers of these monopoly houses. Not that these houses have not benefited from the existing dispensation. Their expectations are that once the IDBI is delinked from the Reserve Bank of India, their ability to corner public funds to bolster their private profits and assets will be enhanced considerably.

It is logical to conclude that once the ‘relative’ independence of the Reserve Bank of India in directing long-term developmental finance through the IDBI mechanism is taken away and powers handed over to a holding company under the direct control of the Banking Department of the Government of India, it will

further strengthen the stranglehold of the monopoly companies on developmental finance in particular and on the economy in general. Delinking of IDBI from the Reserve Bank of India will further encourage the disastrous tendencies of monopoly growth in the country and result in the misuse of resources for non-priority sectors.

In conclusion, it can be asserted that, while the Bill has no economic or administrative rationale behind it, it will have disastrous consequences to the Indian economy arising from the dichotomy between short-term credit and long-term finance, and the definite possibility of higher and easy control by monopoly houses on credit availability. The only logical inference we are able to draw from this otherwise irrational and hasty measure is that the higher officials of the Ministry of Finance, Department of Banking, and the economic power groups are interested in expanding their realm of financial management and control, irrespective of the accepted principles of credit policy and planning and economic rationale.

We totally oppose the Bill and reject the conclusions of the Joint Committee. In our opinion, the Bill should be withdrawn.

New Delhi
July 22, 1975

K. MATHEW KURIAN
DINEN BHATTACHARYA

II

This Bill, in our opinion, being limited to the question of certain structural changes only in the relationship between the Industrial Development Bank of India and the Reserve Bank of India, begs the main question, viz. the credit policies of the public financial institutions, *vis-à-vis* various sectors of industry and areas of industrial development. The Bill does not, at all, venture into any reformulations or redefinitions of Government's basic policies in the matters of financing, promoting and developing industries. To that extent, the Bill is quite inadequate and will have little or no impact on the actual credit map as it has emerged over the years.

Evidence cited before the Joint Committee, more than amply confirmed that the dominant bias in the credit outlook of these financial institutions continues to be in favour of the big business houses. Thus, the five institutions (IDBI, IFCI, LIC, UTI and ICICI) have between them sanctioned loans of over Re 1 crore each to 253 private companies. The total of such loans amounted to no less than Rs 837.42 crores as on 31st December, 1974; out of the 253 companies concerned, 80 received loans of more than Rs 3 crores each. The bulk of the beneficiaries are undertakings attached to one or other of the monopoly houses.

Further, these five financial institutions are holding more than 25 per cent of the paid-up capital in each of 129 companies, representing a total investment of Rs 76.83 crores as on 31st December, 1974. Equity of the value of Rs 25 lakhs and over is held by these institutions in each of 70 companies of the monopoly sector. Even a giant like Tata Iron Steel & Company (TISCO) has 39 per cent of its equity shares held in this way.

It is this pro-monopoly bias in the credit fall-out from the public financial institutions which calls for review and assessment in the light of the declared national objectives and priorities, and for suitable correction through legislation. In our

opinion, the small-scale cooperative, agricultural, marketing and similar sectors are being neglected by the public financial institutions, but all these matters do not come within the purview of the Bill at all.

We had pressed for inclusion of two elected representatives of the workmen employees of the restructured Industrial Development Bank of India to be included as Directors. Ultimately, it has been accepted that there should be one such, but the manner of his nomination/selection has been left to be prescribed. We consider this to be unsatisfactory. There is no reason why elected representatives of the employees should not be on the Directors' Board, as in the case of the nationalized banks, so that they can effectively contribute to the better functioning of the Industrial Development Bank of India in keeping with national priorities.

In the end, we would like to stress that the functioning of the institutions such as Industrial Development Bank of India in the interests of the national economy, and for the promotion of truly national-building economic and social objectives cannot be satisfactorily ensured without certain radical structural changes in the industrial sector.

New Delhi
July 22, 1975

INDRAJIT GUPTA
BHUPESH GUPTA

77

INTERNAL NOTE
IFD
17.2.1976

INDUSTRIAL FINANCE DEPARTMENT

Transfer of functions and staff to Industrial Development Bank of India
consequent upon Public Financial Institutions Laws (Amendment) Act, 1975

The Industrial Finance Department was set up in September 1957 to deal with all matters pertaining to industrial finance, including the activities of State Financial Corporations and the administration of Refinance Corporation for Industry. Later, the administration of the Credit Guarantee Scheme was also entrusted to it. With the establishment of the Industrial Development Bank of India in July 1964, the function of refinance was transferred from Industrial Finance Department to Industrial Development Bank of India. The major responsibilities of IFD are: (i) inspecting and financially assisting the SFCs and coordinating their procedures and policies, (ii) functions which relate to IDBI itself, viz., subscription to share capital of the IDBI by Reserve Bank of India, purchase by Reserve Bank of India of bonds and debentures issued by IDBI, making of loans to IDBI for purchase of or subscription to shares, bonds and debentures issued by Industrial Finance Corporation of India, SFCs and other notified financial institutions, making short-term loans to IDBI, etc., (iii) administration on behalf of the Government of India the Credit Guarantee Scheme, (iv) promotional work connected with the growth

and expansion of small-scale industries, especially their credit needs. The Department opened regional offices at Bombay, Calcutta, Madras and New Delhi in early 1968 with a view to making closer contacts with State Financial Corporations, banks and other bodies, and to play more effectively a promotional role in ensuring an adequate framework of institutional credit for growth and expansion of industries, particularly in the small-scale sector. In view of the greater responsibilities devolving on the Chief Officer, IFD, the post was upgraded to that of Senior Officer Grade I with effect from 18th May 1968.

The Department has been divided into the following five Divisions:

1. Planning Division
2. Operations Division
3. Inspection Division
4. Guarantee Division
5. Administration Division

2. Section 16 of the captioned Act, provides that if, on the appointed day, or any time thereafter, any of the functions of the Reserve Bank is transferred to the Development Bank, that Bank may also take over the staff who were attending to these functions immediately before the appointed day, with the previous approval of the Reserve Bank. Such staff would also be entitled to exercise options within a period of eighteen months from the appointed day and so opting, they should be repatriated to Reserve Bank before the expiration of thirty months from the appointed day.

3. The question of transferring to IDBI the functions of IFD in relation to the affairs of SFCs was considered at length in Central IFD's note dated 15th September 1975, and it has been decided by Deputy Governor (Shri Chari) and D.G. (Se.) that the allocation of work of IFD as between the Reserve Bank and the IDBI consistent with the laws should be as follows:

- (a) All items of work in relation to SFCs such as that relating to establishment of SFCs, raising of their share capital, appointment of Managing Director, approval of General Regulations, underwriting of shares, issue of directives, inspections, etc. will be attended to by IDBI;
- (b) IDBI to scrutinize proposals for issue and sale of bonds and debentures so far as individual SFCs are concerned and to present a consolidated picture to RBI which will then send a reply to IDBI after consulting the Secretary's Department indicating the total amount of distribution and the terms (cf. Section 7 (1) of SFCs Act, as now amended);
- (c) The IDBI to deal directly with the Department of Accounts and Expenditure with regard to borrowing of money by SFCs from Reserve Bank. The DAE will consult the IFD on each reference before taking a decision (Section 7(2) of SFCs Act);
- (d) With regard to borrowing of money by the SFCs from the State Governments, the IDBI, after consulting the SFCs, and the State Government concerned to refer proposals individually to IFD. The IFD will then accord RBI's approval in each case (cf. Section 7(3) of SFCs Act);

- (e) In respect of acceptance of deposits by SFCs, IFD to convey general guidelines to IDBI for communication to SFCs. (cf. Section 8 of SFCs Act);
- (f) The IFD will continue to receive and analyse the monthly and quarterly returns from SFCs as hitherto for purposes of assessing the resources position of SFCs, preparation of statistical statements, notes, etc. (cf. Section 38(1) and (2) of SFCs Act); and
- (g) The expertise now available to IFD, in its Planning Division with regard to SFC's work, training, references relating to industrial finance, etc. should form part of IDBI and the concerned staff in that Division should be transferred to that Bank. The Division will continue to be located on the fourth floor of IFD. (However, the compilation of data received from commercial banks regarding their advances to small-scale industries and transport operators, now being handled in the Planning Division of IFD, will be transferred to Department of Banking Operations and Development.)

In consequence of the above decisions, the staff concerned with the work would also stand transferred to IDBI with effect from the date the work is taken over by IDBI. They now form part of the Operations Division, Planning Division and Inspection Division of Central IFD and its regional offices at New Delhi, Calcutta and Madras. The particulars of staff to be so transferred are listed in the annexure to the note. The General Manager, IDBI, who has been furnished with a copy of the list, has accorded his consent to take them over.

4. In this connection, there is only one issue which needs further consideration of the authorities. The IFD has one-man offices at Indore, Jaipur, Patna and Trivandrum. D.G. (Se.) is of the view that IDBI should also take over the staff attached to these offices. The IDBI, on the other hand, have stated that they already have liaison officers at these centres/regions and the takeover may not be of much use to them. The one-man offices have been attending to promotional work in the field of financing of small-scale industries. This, in the present context, inevitably includes occasional inspection work on behalf of the Credit Guarantee Corporation. Considering the role of such offices, the Chief Officer, IFD has stated in his note dated 22nd September 1975, after discussion with D.G.(N), that these offices may continue to remain part of IFD for attending to developmental work relating to advances granted by commercial banks to small-scale industries. We are afraid this may not be an acceptable proposition. The object in creating the one-man offices as advised to Efficiency and Development Sub-Committee is as follows:

- (i) to help the State Financial Corporations in:
 - (a) formulation of policies;
 - (b) introduction of special schemes for assisting industries;
 - (c) bringing together entrepreneurs and financial corporations and assisting them in preparation of schemes, negotiations of terms, etc.; and
 - (d) attending to developmental functions which are increasingly becoming the responsibility of the Bank.
- (ii) to study the regional and/or sector-wise problems, affecting the industries from time to time so as to help the Bank to evolve appropriate policies and issue suitable advices to the financial institutions; and

(iii) to undertake intensive studies to identify the potential for small-scale industries in different districts of the States, and to have an effective follow-up action.

5. The IFD has been playing a major role in reorienting the loan policies of State Financial Corporations. The one-man offices have been giving an useful feedback to Planning Division of IFD. In this context, the one-man offices have established contacts with SFCs, the Department of Small-Scale Industries in the State Governments, and the Small-Scale Industries Service Institutes. In terms of the provisions of Public Financial Institutions Laws (Amendment) Act, 1975, the SFCs, are statutorily placed under the care of the IDBI. That Bank has, it needs to be conceded, been so far preoccupied with large industrial units and projects. It will take some time for it to develop that comprehensiveness of attitude to industries in which there is equal and constructive understanding of the wide spectrum from very large to very small industries. We feel, therefore, that it will be advantageous to that institution to take over the one-man offices also, as suggested by D.G. (Se.).

6. Pending a decision on this issue, it is proposed to arrange for the transfer of the listed staff to IDBI with effect from 1st March 1976, as the Act provides for taking over any of the functions of Reserve Bank either from the appointed day or at any time thereafter. If this date is approved, it will also reduce financial adjustments for part of the month. This may kindly be approved.

7. The staff listed in the Annexure who are proposed to be transferred to IDBI fall in the following categories:

- (i) Officers in Grade 'B' appointed/promoted prior to 1.1.1970 and the higher grades, who are covered by Group Seniority System;
- (ii) Officers in Grade 'B' appointed/promoted on or after 1.1.1970 and of officers in Grade 'A', both Promotees and Direct Recruits who are covered by the Combined Seniority Scheme as per Administration Circular No. 15 dated 22nd May 1974; and
- (iii) Non-officer staff, for example, Banking Assistants, Clerks, Stenographers, Typists, Peons, etc., who are covered by the Combined Seniority Scheme applicable to their respective cadres.

8. The staff covered by the Combined Seniority Schemes, that is those in categories in (ii) and (iii) above will have a settled position vis-à-vis their counterparts in IDBI, and it will not be difficult to determine their seniority in the IDBI. In regard to officers in category (i) above, the following alternatives were discussed between the General Manager, IDBI and the Chief Officer, IFD, for merging the seniority of the officers who may go to IDBI and decide to stay there:

- (a) On the basis of the length of service in their substantive grade (this has been adopted by the Bank for merging the seniorities of the officers in Grade 'A' belonging to various Groups); or
- (b) On the basis of the date of confirmation in the substantive grade (as per Staff Regulation 28); or
- (c) On the basis of their date of confirmation in Grade 'B'.

The general consensus was in favour of adopting the first alternative, although it was decided to leave the matter open for consideration at higher level. Recently,

the Bank has appointed a Departmental Committee which would, *inter alia*, suggest measures for determining inter-group seniority. It is proposed that the basis suggested by the Committee may also be adopted in case of the aforesaid officer staff.

Pending a decision on this issue, it is proposed to advise the officers, who will be transferred to IDBI that their seniority in IDBI will be advised to them separately.

9. The Chief Officer, IFD has asked for a minimum complement of staff for attending to the residual items of work relating to SFCs as noted against items (c) to (f) of point 3 of the note. This matter will be separately processed.

Although the work relating to SFCs stand transferred to IDBI with effect from 16.2.76, it would be permissible under the Act to transfer men from a different date and for the sake of convenience, we have suggested that 1st March 1976 be the material day for the transfer of staff.

2. Pending decision on the case of one-man offices, Draft Admn. Cir. has been prepared (vetted by Legal Deptt.), which may please be approved.

The proposal made in point 6 of the above note requires to be discussed with the Chairman, IDBI, to ascertain whether the proposed date of 1st March 1976 is acceptable to them. The issue relating to taking over of one-man offices by IDBI, as referred to at points 4 and 5 may also perhaps be discussed again between D.G.(N.) and D.G.(Se.) and suitable orders thereon given.

The other proposals made in the above office note regarding transfer of IFD staff to IDBI are in order.

18.02.76

D.G.(N.)

1. Regarding the proposed transfer of the listed staff of IFD to IDBI with effect from 1st March 1976, CM may informally consult the General Manager, IDBI, who, I think, should have no objection to it.

2. The matter relating to taking over of one-man offices of IFD by IDBI did come up for discussion, but no finality was reached. I agree with D.G.(Se.) that IDBI may also take over these one-man offices.

18.02.1976

D.G.(Se.)

I agree that the services of the officers and staff to be deputed from the IFD to the way be transferred as from 1st March 1976. Technically, this will curtail by weeks the period of eighteen months within the staff so departed will have to exercise options to revert to the Reserve Bank, but reduction in the period will be very slow. No difficulties are likely to be created on this account.

2. In order that the officers and other employees who are transferred may know that their services have been placed at the disposal of the IDBI, the administration circular may however be issued within a day or two.

3. It will be hardly worthwhile for us to consult the IDBI formally or informally about either of the two points referred to in D.G.(N.)'s note dated 18.2.76. The IDBI may be informed about these decisions and so far as the one-man offices are concerned, they may be asked to decide in due course whether these officers should

continue or whether the officers concerned should be transferred to other offices, including liaison offices under the IDBI.

R.K. SESHADRI
19.2.76

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INTERNAL NOTE
2.9.1978

DEPARTMENT OF NON-BANKING COMPANIES

Comprehensive legislation to regulate deposit-acceptance and other activities of financial companies

While examining in depth the provisions of Chapter IIIB of the Reserve Bank of India Act, 1934 and the directions issued thereunder in order to assess their adequacy in the context of ensuring the efficacy of the monetary and credit policy of the country and affording a degree of protection to the interests of the depositors who place their savings with non-banking companies, the Raj Study Group on Non-Banking Companies had made several recommendations for the tightening up of the regulatory measures for acceptance of deposits by non-banking companies. Most of the recommendations made by the Group were accepted by us as well as the Government. In this connection, a reference is invited to Memorandum No.B-18 dated 3rd October 1975 submitted to the Central Board of the Banks. With a view to giving effect to these recommendations, the Directions earlier issued to financial and miscellaneous non-banking companies were replaced by two new sets of Directions effective from 1st July 1977. Similarly, the Companies (Acceptance of Deposits) Rules, 1975 were amended effective from 1st April 1978. Further, a Bill entitled 'The Prize Chits and Money Circulation Schemes (Banning) Bill', drafted by us and forwarded to Government for necessary action was introduced in Parliament in its last Budget Session, and it is likely to be enacted into a law soon. A Bill captioned 'The Chit Funds Bill' was also drawn up by us in the light of the recommendation of the Raj Study Group to be enacted as a central legislation. The Central Government initially called for the comments of the State Governments on the Bill. . . . The Reserve Bank of India Act is also being amended with a view to prohibiting unincorporated bodies from accepting deposits from not more than a specified number of persons, and the necessary provisions in this regard have been incorporated in the Banking Laws (Amendment) Bill, 1978 which is also expected to be introduced in Parliament at an early date.

2. In paragraph 5.54 of its Report, the Raj Study Group has pointed out that most of the financial companies are para-banking institutions which accept deposits from the public for the purpose of lending and/or investment. As such, the activities of these companies in regard to deposits, loans and advances, etc., should be regulated broadly on the lines of the provisions contained in the Banking Regulation

Act, 1949. While issuing the Non-Banking Financial Companies (Reserve Bank) Directions, 1977 effective from the 1st July 1977, only such of the recommendations of the Group as could be implemented immediately within the framework of the existing provisions of Chapter IIIB of the Reserve Bank of India Act, 1934 had been incorporated in the said Directions. It had then been decided that the other recommendations regarding management, capital structure, control of advances, restrictions on the opening of branches, circumstances in which financial companies may be ordered to be wound up, powers for amalgamation, etc. may be included in a comprehensive legislation to be enacted for the purpose as these provisions could better form part of a package deal in the context of allowing certain classes of financial companies to raise funds by way of deposits up to ten times their net owned funds. (as against the present ceiling of 25 per cent of the net owned funds)

3. In context of the above aspects, a Bill entitled 'The Non-Banking Financial Companies Regulation Bill', was drafted by Shri B.N. Chikarmana and forwarded to Central Office. After a few rounds of discussion by the undersigned with him in Bombay as well as in Calcutta, the various provisions of the Bill have been finalized, taking into account the recommendations made in the Report of the Raj Study Group as also certain other developments. A copy of the Bill is placed below. A statement containing brief Explanatory Notes relating to the provisions made there is also attached. While drafting the Bill, we have taken note of legislation on similar subjects obtaining in other countries and a few welcome provisions from the Protection of Depositors Act, 1963 of the United Kingdom as well as the Borrowing Companies Act, 1969 of Malaysia have been drawn upon so as to make the provision in the present Bill as comprehensive as possible. Since, on the enactment of the Bill into a law, certain provisions in Chapter IIIB of the Reserve Bank of India Act, 1934 are proposed to be repealed, such of these provisions as are deemed to be necessary have also been incorporated in the Bill. Similarly, certain essential provisions from section 58A of the Companies Act, 1956 have also been incorporated at the relevant places in the Bill. Though the Bill is, to a large extent, self-contained, it has been expressly provided that the provisions thereof shall be supplemental to and not in derogation of, the provisions of the Companies Act, 1956. This is because the Bill only provides for 'registration' of financial companies with the Reserve Bank and in respect of matters such as incorporation, memorandum and articles of association, meetings etc., the companies would be governed by the Companies Act. It is reported that the Committee's recommendations include, *inter alia*, those relating to prohibiting private limited companies from accepting deposits, restrictions on inter-corporate investments, etc. Full details of the Committee's recommendations are not yet available. In the light of the decisions which Government might take on the recommendations in consultation with the Reserve Bank, it might, perhaps, be necessary to review some of the provisions made in the present Bill so as to ensure that the provisions made therein are in tune with the policy decisions taken by Government on the Committee's Report.

4. A copy of the Bill is being forwarded to the Department of Banking Operations

& Development for their comments, if any, on policy issues. Simultaneously, a copy of the Bill is being marked separately to the Legal Department for vetting.

Submitted for information please.

2.9.1978

JOINT CHIEF OFFICER
DEPARTMENT OF BANKING OPERATIONS & DEVELOPMENT
CALCUTTA

C.O.(IFD)

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IDBI.B.No.32/75-76

ITEM No. 7

MEMORANDUM TO THE BOARD Reorganization of IDBI

Having regard to the present functions and activities of IDBI and the new challenges and opportunities thrown open by the national priorities and the 20-Point Programme by the Prime Minister, I have, on taking over as Chairman of IDBI, given immediate thought to enlarge the scope of its activities and streamline and strengthen the administrative set-up to bring about the much-needed dynamism in its approach and practices. While doing so, careful attention has been given to the recommendations made by the Narasimham Committee to speed up sanctions procedures in IDBI, and also to the recommendations made by the Kumar Committee regarding handling of exports on deferred credit terms. Some of the more important measures to be taken by IDBI with immediate effect are indicated below:

1. Decentralization

At present, IDBI has three Regional Offices, viz., Calcutta, Delhi and Madras but they have very restricted authority to do business, and most of the cases are required to be referred to the Head Office in Bombay. This, besides time consuming, has resulted in a lot of resentment in the minds of the public, as for simple matters, without Head Office instructions, nothing can be done. The Regional Offices, therefore, will have the following delegated authority:

- (i) All refinance cases up to Rs 30 lakhs. The figure of Rs 30 lakhs has been decided as, under the SFCs Act, no SFC is authorized to sanction loans for more than Rs 30 lakhs to an industrial unit. Similarly, work relating to sanction and disbursement of bills rediscounting limits will also be entirely transferred to the Regional Offices. However, sanctioning of annual limits bank-wise and policy formulation will be handled in the Head Office.
- (ii) All direct finance cases up to Rs 50 lakhs provided no participation from any other all-India institution is involved. Such direct finance cases will be within the overall policies of the Head Office.

- (iii) All work relating to appraisal, documentation, follow-up, recovery, etc. in respect of (i) and (ii) above will be the responsibility of the Regional Offices, subject to overall guidance of Head Office.
- (iv) Small- and medium-sized projects suffer, to a great extent, in two respects, viz., management and costing. Action will be taken to recruit qualified and licenced personnel from the managerial and accounts lines in the Regional Offices to advise and introduce systems for the benefit of the entrepreneur of small and medium projects covered under IDBI finance.
- (v) All projects having a total project cost of up to Rs 1 crore and covered under IDBI finance will have management guidance from the Regional Offices. This will ensure good management and recovery.
- (vi) The Calcutta and Madras Regional Offices have been upgraded and placed under Deputy General Managers like the New Delhi Office. Further, a Regional Office for the Western Zone is being set up shortly under the charge of a Deputy General Manager. The Regional Office will be located at Ahmedabad. In order to keep the Dy. General Managers comparatively free from day-to-day desk work, to begin with, each of these three Regional Offices will have one Manager to attend to the daily routine work, so that the Dy. General Manager may devote more time to developmental and promotional activities. Further, the Regional Offices will be strengthened with more technical and financial officers and other supporting staff. This will be done gradually on the basis of the workload.
- (vii) An Export Credit Cell and a Regional Development Cell are being set up immediately in all Regional Offices. The Export Credit Cell will attend to matters relating to IDBI's export credit schemes and also handle the IDA and other foreign lines of credit. The Regional Development Cell will be involved in the implementation of measures for development of backward areas and removal of regional imbalances. In due course, the Regional Offices will be given necessary authority to process export proposals.

When the above proposals are fully implemented, about 65 per cent of the total business transacted by it will be covered under the decentralization programmes.

2. Delegation of Powers to the Officials

At present, there is inadequate delegation of powers to the officials at the Head Office and Regional Offices. The present delegation covers, to a certain extent, refinance and rediscounting assistance. For quick disposal of cases powers are being delegated appropriately to various cadres of officers including the Executive Directors. For this purpose, a separate memorandum is being put up to the Board.

3. Reorganization of the Export Department

3.1 The Export Department in the IDBI is responsible for taking care of the engineering exporters exporting engineering and capital goods on deferred credit terms. IDBI has been appointed by the Government as a focal point for giving a package clearance on behalf of the Reserve Bank of India, ECGC, IDBI and concerned commercial banks of the exporters. It is also expected to render

counselling services to the engineering exporting community. The Department has introduced quite a few schemes which have turned out to be popular for exporting goods on credit terms.

- 3.2 In 1974, Government of India appointed Export–Import Bank Committee to prepare a blueprint for setting up an Export–Import Bank. The Committee submitted its report in August 1975.
- 3.3 In the opinion of the Committee, the new institutional framework is to be chosen from any of the three options, namely:
 - (i) a major restructuring of IDBI;
 - (ii) a subsidiary of IDBI; or
 - (iii) a separate Export (or Export–Import) Bank. The Committee felt that the first two courses of action would have three main advantages: (a) availability of staff expertise already built up by IDBI in this field; (b) availability, presumably at no cost, of existing facilities in IDBI with regard to appraisal, administration and accounts; and (c) absorption of losses arising from export transactions in the profits from the other operations of IDBI. These advantages may also be available to a subsidiary of IDBI. The Committee carefully considered the first two courses of action and recommended that a beginning might be attempted ‘by restructuring IDBI or, next, forming a subsidiary of IDBI’.
- 3.4 According to the Committee, the restructuring of IDBI as envisaged by it should be effected by a division of IDBI into two separate wings—one for domestic operations and the other for exports, both wings to be of the same status; strengthening and upgrading the present Export Department and placing it in charge of an executive who would have considerable delegated authority and freedom for decision, and would report directly to the Chief Executive of IDBI.
- 3.5 The Committee has, however, urged the creation of a separate Export–Import Bank ‘if for any reason it is possible for Government and others concerned to accept in toto’ the proposals for restructuring IDBI or the establishment of a subsidiary of IDBI.
- 3.6 I am of the firm opinion that, to begin with, strengthening of the Export Department in IDBI with adequate authority and staff and raising its status to that of an International Finance Division would be preferable to the setting up of a subsidiary of IDBI. The establishment of a subsidiary will be time-consuming and is not justified by the volume of present business in IDBI. IDBI’s disbursements under its various export finance schemes have not, so far, exceeded Rs 22 crores per year. The question of setting up a subsidiary could be considered if the volume of business (disbursements) exceed Rs 100 crores.
- 3.7 In view of the foregoing, I have already upgraded the Export Department as the International Finance Wing under the charge of an Executive Director.

4. *Coordination with IFCI, ICICI, LIC, UTI and IRCI*

- 4.1 At present, the only coordinating machinery is through the forum of Inter-Institutional Meetings held every month. This forum attends to the following tasks:

- (i) formulating common operational policies in the field of industrial assistance;
 - (ii) discussing specific proposals for assistance for coordinating appraisal, sharing assistance and deciding conversion terms;
 - (iii) formulating strategies for follow-up of assisted units, especially problems units, including relaxation of conditions for grant of assistance, appointment of nominee directors, etc.
- 4.2 The concept of lead institution has been introduced for follow-up work. Under this scheme, one of the institutions designated as 'lead' institution gives approvals under the loan agreement on behalf of all institutions, for example, appointment of managing directors, expansion schemes, etc. In regard to pre-sanction (appraisal) work, while one of the institutions is designated as the lead institution, all the institutions carry out separate appraisals themselves, though in a coordinated manner, and if need be, by referring again to IIM. Separate appraisals and frequent references to IIM, even on simple operative matters lead to delays in sanction of assistance.
- 4.3 In order to make coordination more effective and fruitful, I contemplate the following action:
- (i) IIM to be attended by Chairman/Chiefs of all institutions mainly to deal with important operational matters. Any proposal beyond the limit up to which a financial institution is allowed by IDBI to support on its own or in participation with another institution and requiring IDBI assistance will be examined in IDBI immediately on receipt thereof and a flash report will be prepared. This will broadly indicate either the acceptance of the proposal as received or with any modifications. The copy of the flash report will be sent to each institution concerned (including the Bank/s). The IIM will discuss the proposal and decide, *inter alia*, to (a) who should be the lead institution and (b) who should be the common solicitor to take care of the legal aspects IIM shall meet once a month.
 - (ii) In the IIM, besides the matter referred to above, important issues like promoters' contribution business plans for institutions, as a whole, on the basis of a detailed review of applications pending and in the line, so as to ensure allocation of institutional funds to various industries and sectors, keeping in view national priorities will also be considered. The main idea here is to develop consensus on important matters so that Government may formulate its policy on the basis of the consensus reached.
 - (iii) The concept of lead institution at the appraisal stage will be made more meaningful by locating entire responsibility for appraisal on the 'lead' institution, particularly in the case of smaller projects, say with cost up to Rs 5 crores. The 'lead' institution will give its appraisal report to other institutions for consideration at their Boards. This will reduce the time factor for sanction of proposals significantly when more than one all-India institutions is involved. The work of documentation and disbursal will be done by the 'lead' institution on behalf of all the participating institutions. The 'lead' institution will work on the basis of the time-bound programme to ensure that no

proposal under any circumstances will be detained without sanction and first disbursement beyond a maximum period of six months.

- (iv) IDBI is already having nominees on the Boards of IFCI and IRCI. So far, Deputy Governor, RBI, in-charge of IDBI, used to be on LIC's Board. With delinking of IDBI from RBI, IDBI representation on the Board of LIC is considered essential for effective coordination. Similar representation is also desirable on Boards of ICICI and UTI.

Coordination with IRCI is already ensured through nominees of IDBI, IFCI and ICICI on the IRCI Board. Its activities are also distinct and do not require coordination through the IIM forum.

5. *Coordination with Commercial Banks*

5.1 With the delinking of IDBI from RBI, link with commercial banks through RBI will no longer be there. As an apex term-lending institution, linkage is considered essential mainly on two grounds, viz., (i) meaningful coordination in the field of industrial finance, and (ii) for financial support of commercial banks in the projects approved by IDBI and other all-India institutions.

5.2 So far, IDBI's contact with commercial banks has been mainly through refinance and rediscounting assistance, from occasional association of banks in consortium arrangements for providing term finance to very large projects (such as, Southern Petrochemical and Mangalore Fertilizers) and respect of certain other projects where working capital deficit persisted. For an effective coordination with commercial banks, following steps will be desirable:

- (i) Nomination of IDBI officers on Boards of State of India, its subsidiaries and all nationalized banks.
- (ii) Six monthly meetings of Chairman, IDBI with Chairmen of commercial banks will be coordinated with periodical meetings of the Chairman, IDBI with RBI Governor.
- (iii) Devising standing arrangements for participation of banks in all or most of the projects with cost above Rs 25 crores. This will avoid delays in making efforts at a later stage to associate banks in case of gaps.
- (iv) The institutions to identify, at the IIM stage, commercial banks if needed, besides the bank of the entrepreneur, which could take care of working capital required of their assisted industrial units. The flash report as an appraisal report of the 'lead' institution will be freely made available to banks.
- (v) Banks giving working capital finance to industrial units assisted by IDBI and other institutions to be closely associated with post-disbursement follow-up work. Banks will furnish quarterly reports regarding operations in cash credit/overdrafts accounts, inventory position, company's financial position as also summary inspection reports to the financial institutions.

The inspection reports of all-India financial institutions will also be made available to commercial banks.

- (vi) Credit authorization, in respect of term loans beyond Rs 25 lakhs should be made automatic if an all-India institution is involved in the project. In case no all-India institution is involved, RBI, as a matter of procedure, should

refer all such cases to IDBI for its views. The latter course will avoid sanctioning of term finance to projects by banks which have been either rejected or not considered viable by all-India term-lending institutions.

6. *Coordination with State Level Institutions, viz., SFCs and SIDCs*

6.1 The IDBI will have close association with State Financial Corporations (SFCs) mainly through

- (i) Regular inspection and supervision of SFCs' operations;
- (ii) IDBI can nominate 2 directors on each SFC Board. It will be desirable to put Regional Chiefs and senior officials of the regions on the Boards of the concerned SFCs. The second nominee could be an outside professional.

6.2 The long-term objective is to improve appraisal and follow-up standards of SFCs and to transform them into Regional Development Banks which are not security-minded but project-oriented, and are equipped to give technical and managerial assistance for project implementation and operation, particularly in small-scale sector. In the immediate context, IDBI will do the following:

- (i) Augmentation of training activities and upgradation programmes for improvement of operational efficiency as already initiated under the IDA line of credit.
- (ii) Creation of a special SFCs Department in the IDA. This Department, in addition to normal serving of SFCs, in particular gives special attention to ensure proper allocation of SFCs' loan portfolio among different industries and districts, with special emphasis on assistance to the small-scale sector, new and technician entrepreneurs and the specified backward districts. For this purpose, IDBI will issue operational guidelines and scrutinize their business plans.
- (iii) SFCs Conferences which have, so far, been held every alternate year, will be made an annual feature.

So far as State Industrial Development/Investment Corporations (SIDCs/SIICs) are concerned, IDBI has made a detailed study of their operations and formulated proposals for granting refinance assistance to them. The basic task of reorganizing SIDCs/SIICs has to be taken up immediately.

7. *Prime Minister's 20-Point Programme and the IDBI*

7.1 The main focus of the 20-Point Programme is improving the lot of the common man, and the IDBI would be able to play an important role in achieving this objective. With a view to diffusing fruits of industrial progress, enhanced emphasis on the development of backward areas and creation of a generation of new and technical entrepreneurs is necessary. It has been widely accepted that promotion of small- and medium-scale industries that help to reduce concentration of income and property deserve a preferential treatment. Keeping these objectives in mind, the following schemes, some of which are new for IDBI's activities, are being taken up on priority basis.

1. *Assistance to SIDCs*

A reference is already made about bringing SIDCs into the fold of IDBI's

activities so as to promote, through these agencies, balanced regional development, especially by encouraging location of projects in backward areas. While doing this, preference could be given to labour intensive projects that exploit locally available resources. To start with, needs of relatively less-developed states may be given a priority in allocating funds to SIDCs.

2. Financing Entrepreneurs' Equity

A number of competent new and technical entrepreneurs do not have resources adequate enough to satisfy financing institutions' requirement of minimum desired level of promoter's contribution of 15 per cent of the project cost. IDBI will take a lead in this field and operate such a scheme in respect of its directly financed projects. Secondly, it will also encourage the SFCs or SIDCs to initiate such schemes by assuring refinance assistance in respect of their loans against promoters' equity. It is only through such schemes that entrepreneurial ability of the financially less-favoured class could be put to more effective social and economic development.

3. Finance for Hire-Purchase Schemes

A number of Small-Scale Industries Development Corporations (SSIDCs) are supplying machinery on hire purchase basis. IDBI will soon initiate a new scheme whereby each of such State level agencies gets a small credit limit of IDBI, and it is proposed to make available the finance at the same concessional rate as that applicable to refinance to SFCs in respect of their loans to SSI units.

4. Transport Operators

The existing schemes of bills and refinance do take care of the needs of transport operators. Under the bills rediscounting scheme, there is no stipulation regarding the promoter's minimum contribution for financing purchase of trucks. But under the refinance scheme, there is an insistence of 15 to 25 per cent minimum of promoter's contribution, depending on whether the promoter is owner-driver or otherwise. Under the 20-Point Economic Programme, the scheme relating to National Permit for goods transport operators envisages, among other things, that 25 per cent of the permits should be granted to new entrepreneurs including ex-Army personnel and unemployed drivers. IDBI would not insist on promoter's minimum contribution while refinance loans given by the SFCs and banks to the permit holders that get licence under the category of the 20-Point Programme.

5. Consultancy Services

IDBI has taken lead to establish three consultancy organizations already. IDBI will soon establish at least one such consultancy organization in each of the relatively less industrialized states. These consultancy organizations will be strengthened by posting adequate technical staff so that these organizations play an effective role in identifying viable projects, preparing detailed project profiles up to their bankable stage and locating entrepreneurs who would implement them. It is necessary to ensure a bias in favour of projects suited to the needs of SSI units and new and technician entrepreneurs. These consultancy organizations would serve as a focal point for IIGs at the state level and generate a climate for industrial growth, especially by organizing training programmes

for development of new entrepreneurs. They could also play a very useful and constructive role by providing necessary marketing intelligence to the needy, small and medium entrepreneurs who cannot possibly afford hiring private market intelligence consultancy services.

6. New Apprenticeship Scheme

The twentieth point in the Prime Minister's 20-Point Programme relates to enlarging scope of training programmes, especially of the weaker sections of the population. IDBI will also provide facilities to 100 apprentice trainees with commerce, economics, engineering and technical qualifications who could be subsequently absorbed in the organization if found suitable. Those who do not fully meet our requirements may prove to be adequate for SFCs, SIDCs, etc. These agencies would find it advantageous to recruit IDBI trained personnel. It is an advantage in making the apprenticeship scheme as a regular feature to meet IDBI's growing requirements of manpower. IDBI would also encourage its assisted companies especially those which are doing well to augment apprentice training programmes and our nominee directors may be required to take active interest in this matter.

- 7.2 The Schemes 1 and 3 discussed above could be initiated only after Government issues a notification specifying that SIDCs as well as SSIDCs are eligible institutions for IDBI's financial facilities. Scheme 2 also has to wait for a Government notification empowering IDBI to finance promoter equity which will be held in trust until a stage when the promoter is able to buy it back. I have already written to the Government on these points for enabling the IDBI to undertake these new activities. As regards schemes 4-6, I have taken a decision to go ahead with them immediately.

8. Assistance to Sick Units

A. IDBI assisted units

- 8.1 In order to attend to units which have grown sick or are showing signs of sickness, IDBI will have a full-fledged Department (Loans Department No. VI) with sufficient complement of technical and other staff for: (a) diagnosing the factors leading to sickness and (b) devising time-bound programme of remedial action. The Department should be in a position to depute its own personnel, where necessary, and where this is not possible the Department will appoint outside competent professionals to take care of the unit on the basis of the action plan prepared by the Department. In other words, the Department should be in a position to provide intensive care to problem units.
- 8.2 As a preventive measure, IDBI will tone up its monitoring system as follows:
- (i) Project Teams will be associated with the project right from appraisal to recovery of loans and will be primarily responsible for close follow-up. Their association and regular visits will establish better rapport with the assisted unit.
 - (ii) The top management of the assisted unit will meet the General Manager of the Domestic Finance Wing at least once in six months for an overall discussion on the project.

- (iii) Commercial banks are in day-to-day contact with their clients. They will be requested to send the concerned Branch Manager's periodical reports about operations in the account, inventory position, working of the unit and its financial position. IDBI will also make its inspection reports freely available to banks.
- (iv) Annual reviews of all accounts and half-yearly reviews of difficult accounts (with action taken) will be undertaken. The concerned Regional and Branch Office will also visit the assisted units to discuss their problems. They will submit their reports to the Head Office half-yearly.
- (v) There will be a nominee of IDBI or a participating all-India financial institution on the Board and Managing Committee of every assisted sick unit. The concerned Loan Department will regularly brief him and get the necessary feedback.

(B) Modernization/Rehabilitation Programmes of Units Referred to IDBI by Government

- 8.3 Recently, the Cabinet Committee while considering the proposals of the Ministry of Commerce for an integrated national cotton textiles policy decided that priority should be given in the allocation of resources to the programme for modernization and rehabilitation of sick mills, preference being given to the units under the National Textile Corporation; for this purpose, IDBI is required to set up a special cell which should start functioning from the beginning of April 1976. The Ministry of Finance, Department of Banking has requested IDBI to take early steps to implement the decision of the Cabinet Committee. The Department of Banking has also advised IDBI that besides cotton textiles industry, modernization/rehabilitation programme of sugar, cement and engineering industries is also required to be assisted to save the units from becoming 'sick'. The IDBI is in touch with the Government and has enquired about exact financial implications and the funds likely to be made available to IDBI by the Government for the purpose.
- 8.4 Under the existing schemes of lending, modernization/rehabilitation programme of industrial units is assisted by IDBI through the Bills Rediscounting Scheme under which the maximum repayment period is seven years. However, the Government now desires that the units implementing modernization/rehabilitation programmes may have to be given longer repayment period with three to five years grace period. It is, therefore, clear that the modernization/rehabilitation programmes of these units will have to be assisted by IDBI under the direct loan/underwriting schemes. The work in this connection will be taken over by Loans Department V.
- 8.5 To implement the above programme, the following measures will be taken:
- (i) Government will be requested to prepare guidelines for units to become eligible for special assistance;
 - (ii) Once a unit comes under surveillance and assistance of IDBI, the nature of weakness will have to be first ascertained by deputing experts;
 - (iii) If on assessment, the view taken is that the unit is not likely to be viable, say within a period of five years, the merger of the sick unit with another unit

will have to be actively considered. For this purpose, whatever assistance is required to be provided to the transferee unit, will have to be considered by the all-India financial institutions and commercial banks jointly.

- (iv) Where a sick unit could be made into a viable unit, appropriate changes in the management set-up will be effected by appointing suitable persons directly by term-lending institutions under the Management Guarantee System as explained in para 9 (i).

(C) *IRCI assisted units*

8.6 So far, IDBI has not directly got involved into the projects assisted by IRCI. In order to coordinating of policy matters and assistance programme, Loans Department will get directly involved in the projects under IRCI and render assistance. The assistance could be either in the management, technical or finance field on the merits of each case.

9. *Management of assisted projects*

The current practice in IDBI is that it keeps in touch with the assisted concerns mainly through periodical progress reports and ad hoc inspections. In some cases, nominee directors are appointed. However, so far, adequate attention has not been given to the management aspect of the assisted concerns. As a result, IDBI comes to know of the troubles in the assisted projects fairly late. To overcome the situation, the following action will be taken:

- (i) Wherever financial institutions feel that the management of a project leaves scope for improvement, right from the beginning that project should be under the close surveillance of financial institutions. This will not only take care of the scarce resources of financial institutions made available to projects, but will also develop healthy convention in the management field as has developed in Japan and certain other developed countries. In this context, management guarantee, which is not so uncommon in certain industrially developed countries, would be considered actively.
- (ii) At present, nominee directors are appointed on the boards of assisted concerns from a panel of persons finalised jointly by the various all-India financial institutions and approved by the Banking Department in the Ministry of Finance, Government of India. The role of the nominee directors in many cases has been more of a passive nature. In order that the nominee directors play a more effective and useful role, selection of nominees will be made more from the professional groups. With this object in view, the Chairman, IDBI will review the panel and select suitable nominees. The idea is that the nominee directors should be able to work more effectively by carrying out the directions of IDBI and provide a feedback regarding the operations of the company.
- (iii) In the case of assisted concerns which are in bad shape or likely to prove so, immediate steps should be taken by IDBI to place one of its senior officer as a full-time director of the concern to take care of IDBI's interests. In this context, it may be pertinent to mention that in Japan, at the initial stage

itself, the financial institutions place their own men in senior positions in the assisted concerns on a whole-time basis and they, besides looking after the work of the concerns, periodically met financial institutions for reporting purposes. This way, a close liaison is maintained and it has paid good dividend to the financial institutions in Japan.

10. Regional Development Programme

IDBI has taken various steps in initiating projects in different backward areas. However, while doing so, sufficient emphasis does not seem to have been given in areas where either the entire state or a major portion of the state has been classified as backward. The following actions will be useful to remedy the situation:

- (i) In the states of the types mentioned above, immediate action will be taken in cooperation with the leading banks in those areas concerned and SIDCs to identify and initiate projects.

Besides financial assistance, IDBI's technical and financial offices will get directly involved in setting up and running those projects till they are handed over to entrepreneurs nominated by SIDCs or the concerned State Government.

- (ii) To start with, a few backward districts will be picked up from the Eastern, Central and Hill Regions as pilot projects and the operational areas will be enlarged on the basis of the experience gained.

11. Problem Accounts

11.1 At present, there are 197 operating accounts with an aggregate outstanding balance of Rs 152.03 crores. Of these, 74 accounts are creating anxiety and the extent of default towards interest and principal aggregates to Rs 16.48 crores. Out of these 74 accounts, 34 accounts need immediate attention to protect IDBI's interest as the defaults are of a persisting nature. Besides these accounts, there are quite a number of other accounts in which equity and preference shares have devolved on IDBI because of underwriting commitments. Some of these accounts would also need immediate attention as the assisted units are in bad shape.

11.2 As of date, only a very small cell with limited staff has been taking care of only five accounts, and the rest of the problem accounts are being handled in a routine manner. It will, therefore, be necessary to organize immediately a Project Care Cell with adequate financial and technical staff for taking care of IDBI's interest as well as to nurse the projects in trouble. This will be done by Loans Department VI.

12. Documentation

12.1 In IDBI, certain documents like the loan agreement, deed of hypothecation, undertaking to execute the legal mortgage, power of attorney, etc. have been standardized. However, the principal document is the Memorandum of Entry in connection with the equitable mortgage and relevant resolutions. Although the latter documents have been standardized to a large extent, these are required to be sent to the other participating financial institutions/banks for their approval. This is a point where all the time is taken.

12.2 Another area of major delay relates to executing of loan agreements where approval is to be obtained by the companies from its shareholders and the Central Government under Section 81(3) (b) of the Companies Act, 1956. IDBI has already taken up the matter with the Government for simplification of the procedure to cut down delays.

12.3 IDBI will take immediate action to standardize the Memorandum of Entry with other participating institutions to reduce the time factor. IDBI's Legal Advisor will attend all IIM meetings and advise all members of IIM on the basis of common legal policy. For this purpose, all financial institutions at the Central and State level will work through a Common Solicitor instead of separate solicitors as at present, and the coordination in this matter will be done by the Legal Advisor of IDBI. This will, to a large extent, eliminate delays. IDBI will examine immediately whether by forming a trustee company for the purpose of taking a floating charge over the assets of the assisted companies, the time factor could be further reduced.

13. Resources Position

13.1 As regards the sources of funds, apart from the accruals through repayment of loans by borrowers and internal cash generations, borrowings from the RBI and through bonds and debentures have, so far, constituted the main sources. The position for 1974-75 is as follows:

	% to total sources of funds in 1974-75
a) RBI's NIC (LTO) Fund	31.6
b) Repayments by borrowers	36.3
c) Short-term borrowings from RBI	15.7
d) Market borrowings by way of bonds	6.0
e) Internal cash generation (interest, commission, etc.), drawings of liquid resources etc.	10.4
Total	100.0

13.2 Estimating requirement of resources for IDBI during the next few years up to 1979-80 is bound to be a somewhat difficult task in view of the fact that several new responsibilities will have to be undertaken in view of the enlarged role assigned to the restructured IDBI. On the basis of certain assumptions, an assessment is made about overall requirement of resources and the projections given below will be taken rather as to indicate figures of the trends to follow. It may be noted that the resources requirements as projected below are in addition to those receipts that would accrue as repayment from the borrowers, and also internal cash generations.

Year (July-June)	Additional Resources Required (Rs crores)
1976-77	282
1977-78	313
1978-79	321
1979-80	329

13.3 The additional resources of Rs 282 crores requires during the year 1976–77 will have to be met as under:

- (i) The RBI has been making NIC (LTO) funds to the IDBI from out of profits. These allocations were stepped up from Rs 86 crores in 1974–75 to Rs 125 crores in 1975–76. In addition, the RBI also provides short-term accommodation against the lodgement of rediscounted bills. In order to meet the demand for additional resources in 1976–77, RBI should make available about Rs 165 crores under the NIC (LTO) allocations for the coming year. It is also necessary that this facility is made available to the IDBI at a reasonable rate of interest of 6 per cent, the same as in coupon rates on its bonds.
- (ii) Besides the NIC (LTO) allocations, the amount that IDBI could raise through bonds should be stepped up to Rs 67 crores during 1976–77.
- (iii) The budget for 1976–77 provides that surcharge now levied at 5 per cent on the income tax paid by companies can be saved by those who pay the money in deposits with the IDBI for five years. This will certainly make resources available to the IDBI, and it is estimated that for the year 1976–77 it should be possible to get about Rs 50 crores which may increase up to Rs 65 to Rs 70 crores by 1979–80. It may be added that these figures indicated here are based on certain assumptions made regarding profitability of the corporate sector during the period to follow, and also that surcharge would continue to remain at the present rate of 5 per cent.

13.4 Unless funds are provided by IDBI at a lower rate of interest, it will be difficult for IDBI to work profitably because of the mounting defaults in payment of interest and repayment of principal by the borrowers.

14. Recruitment of Staff

Now that the RBI machinery will not be available for recruitment of our staff, immediate steps have to be taken in this regard to recruit staff at various levels for our urgent needs. For this purpose, the Chairman will appoint a selection board consisting of three persons from outside with proven administrative ability, plus an Executive Director from IDBI. One of the outside persons will be an eminent financial expert.

15. Administrative Set-up

On the basis of the broad ideas I have set out above regarding the reorganization programme of IDBI to meet the objectives of the Government in restructuring the IDBI as the apex term-lending institution in the country, both in the fields of domestic term financing and international financing, I have, with effect from 8th March 1976, created two distinct and separate wings in the IDBI, with equal status, viz., the Domestic Finance Wing and the International Finance Wing. Certain areas of work which need to remain independent of these two wings will be under my direct charge. The Organization Chart of the restructured IDBI is attached. It will be observed therefrom that each wing has been placed under the charge of an Executive Director. Shri C.S. Venkat Rao has been appointed as the Executive Director of the Domestic Finance Wing, and Shri O.P. Gupta as Executive Director

of the International Finance Wing. Sarvashri Venkat Rao and Gupta have vast knowledge and experience in their respective fields. In order to give support to the two wings, certain appointments have already been made by posting persons from within and it is necessary to make additional appointments for certain specialized categories on the basis of requirements from RBI Banks, etc.

16. The Board is requested to pass the following resolution.

‘Resolved

That the Chairman’s Memorandum IDBI. B.No.32/75-76 dated 17th March 1976 be and is hereby recorded.’

Industrial Development Bank of India
17th March 1976

RAGHU RAJ
CHAIRMAN

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INTERNATIONAL SEMINAR ON BANKING AND DEVELOPMENT*

The following Report on the International Seminar on Banking and Development presents a record of the views expressed at the Seminar on the various subjects. There was no attempt at the Seminar to draw agreed conclusions. The object of the Seminar, on the other hand, was to obtain an exchange of views and a comparison of mutual experiences on problems that arose in the process of adaptation and orientation of the banking and financial system in developing countries to the new and varied needs of development. The Report is to be read in this light.

An International Seminar on Banking and Development, sponsored by the Reserve Bank of India, was held from 9 to 12 February 1970, in Bombay. The participants in the Seminar included a number of Governors, Deputy Governors and senior officials of several central banks, bankers and economists from the developed and the developing countries.

After the inaugural session, the Seminar discussed the theme of Banking and Development in terms of: (a) Commercial Banking and Development, (b) Specialized Financing Agencies, and (c) Central Banking and Development, in three separate sessions held on 10th, 11th and 12th February 1970. These sessions were presided over by Governor Mubiru (Uganda), Governor Ismail (Malaysia), and Governor Phillips (Australia), respectively.

The Seminar was inaugurated by Shri L.K. Jha, Governor of the Reserve Bank of India. In a message on the occasion of the Seminar, the Prime Minister Smt. Indira Gandhi stressed the vital importance of economic growth for the poorer countries. ‘Of the many structural and institutional changes that are necessary in developing countries, not the least important is the adaptation of the financial institutions to

*The Reserve Bank of India is shortly bringing out a volume containing the papers presented at and the proceedings of this Seminar.

serve the objectives of development and to bring about greater mobility of resources to meet the emerging needs of the economy. While each country has to find its own answer to its problems, the experience of other countries, developed and developing, can provide important and useful guidelines.⁷

Inaugurating the plenary session, Governor Jha referred to what he called the central banker's dilemma in developing countries, namely, of the equal concern which Central Banks in such countries had to pay to growth as well as stability, especially when, more often than not, these two factors exercised pulls in opposite directions. He referred to the fact that the tools employed by Central Banks in developed countries did not serve too well than those in developing countries. Central Banks in the latter had to benefit from the experience of those in the developed countries.

During the plenary discussions on the first day, it was stressed that the problem of development was a continuing one, and no country could regard itself as having reached the peak of its development efforts. It was pointed out that the problem of financing development was thus one of importance to central banks of all countries, whether developing or developed. Even developed countries have within their jurisdiction underdeveloped areas.

It was stressed that financial institutions had a crucial role to play in the development process. Such institutions had to play an important role in the mobilization of voluntary savings. One had, however, to guard against the danger of attempting to transplant institutions which have done well in a particular environment to countries and situations where the environment is quite different. For instance, a view was expressed that it was not necessary to rely on the financial market mechanism in every country. While financial markets might, in certain situations, be helpful, they might, in certain circumstances, lead to a misallocation of resources in relation to a national economic plan. However, regardless of how far reliance was placed on market mechanism, there was need for appropriate and economic pricing policies—especially pricing of capital and of foreign exchange.

While inadequacy of savings and pressure on financial resources in relation to investment needs was the general case, it was pointed out that this was, by no means universal. Thus, there were instances of developing countries having fairly well-developed financial systems, whose external payments position was strong and where the banking system's liquidity was comfortable. Yet there was a dearth of adequate and suitable local investment openings. Here it was a problem of putting the resources to fuller use. Development financing organizations could supplement monetary policies by channeling finances to developing areas. The Seminar recognized that for the effective and purposive functioning of monetary policy, some other conditions had to be fulfilled. The most important of them was the type of fiscal policy pursued. The Japanese example of overloaning by banks was cited as an indication of a somewhat unorthodox credit policy against the background of fiscal orthodoxy.

Monetary policy, it was generally agreed, should help create a proper environment for savings and this was possible only when inflation was under control. In cases where the industrialized countries took sharp deflationary measures to

correct continuing inflation, this could affect the world economy and impede development efforts in less-developed countries.

One of the speakers said that in countries such as Yugoslavia which were moving from a centralized to a decentralized system, the efficient operation of the financial mechanism in mobilizing and allocating savings became more important.

II

In the discussion on Commercial Banking and Development, speakers stressed that in order to accelerate the process of economic growth, commercial banks should play a greater role in development. While the basic concept of banks being trustees of public deposits was stressed, banks should interpret the concept of security while lending in a broader and more meaningful way to cover assured repayment, rather than the presence of collateral security.

Banks could with advantage seek to tag on saving schemes to lending in rural areas and to the small man as a means of deposit mobilization and credit expansion over a wider area as well as of spreading the banking habit.

It was observed that in the matter of spreading banking business in rural areas, interest rates alone, though important, might not be a decisive factor. The banks should seek to provide a variety of services to the community which they served.

There was some discussion on the relative advantages of unit versus branch banking in the context of the wider spread of banking. It was felt that unit banks were apt to be small, and not likely to have sufficient resources to function on a viable basis, and hence there were certain limitations to a widespread resort to setting up of such banks. In the circumstances, it might be better to ensure that the branches functioned with a greater degree of local autonomy.

Deposit mobilization required constant attempts at innovation. Commercial banks had to constantly seek to improve the services offered. Competitiveness among banks is helpful in improving their efficiency and services to the community.

III

In the session on Specialized Financial Agencies, several speakers stressed the need to set up development financing institutions to stimulate investment in a country as a whole, or in the developing areas and to act as a catalytic agent to raise investment above the level of current savings. It was recognized that development financing institutions could provide a useful link between foreign financial institutions and domestic borrowers. It was mentioned that whether development banks specialized in certain fields of activity or were multiple financing agencies would depend on the size of a country and the diversified needs of development, but a preference was expressed against a proliferation of institutions.

While in the initial stages, development banks would have to draw their resources from budgetary allocations, it should be the endeavour of the development banks at later stages to resort to the capital market for their resources. The central bank had a specific role to play in providing the appropriate environment for the success of the issues of development banks.

It was indicated that in some countries the problem was not one of relative

paucity of savings but of investment opportunities. In such cases, development banks should assist in drawing up a programme of development either for the country or in specific sectors so as to increase the demands to be made on them.

A number of speakers suggested that as far as possible, concessional rates of interest by the development banks should be limited to exceptional cases. Charging market rates of interest by development banks would not only impose financial discipline on the borrowers but also facilitate their borrowing programme in the market at appropriate rates.

It was suggested that development financing institutions should pay with regard to the commercial viability of transactions. The importance of ensuring the repayment of the loan was also stressed. In this context, the need for having a credit intelligence and credit information system was pointed out.

Some of the speakers stressed that it was advantageous to have a link between development banks and the central bank. It was suggested that while conditions differed from country to country, the central bank being the agency to coordinate the activities of all financial institutions and for ensuring economy in the possession and use of funds, such a link would be beneficial.

It was recognized that in certain situations it was necessary to provide infrastructural facilities which would not be suitable for financing by development banks, but would have to be provided by budgetary support or by special agencies set up for that purpose.

The views was expressed that notwithstanding the increasing role of commercial banks in term lending, there were certain functions which development banks alone could discharge. Development banks were likely to have the necessary technical competence to evaluate projects and also to be in a position to undertake certain long-term financing operations.

IV

In the discussion on Central Banking and Development there was a consensus that, with all the refinements of theory and the statistical and other data available, there could be no precise rules and techniques in matters of central banking. Central banking, thus, remained an art to be perfected by practice. Not all the Central Banks can use the traditional means of credit control and monetary policy, and there is room for adaptation and innovation. An important task of the Central Bank is to give advice to Government, sharing the latter's concern with economic development. The Central Bank should publish relevant material—statistical and other—to help educate public opinion in these matters.

Price stability and development have been major concerns of Central Bankers, but monetary policy, by itself, cannot ensure either objectives. Monetary policy has to be viewed as part of economic policy in general, and fiscal policy is of vital importance in this context. Coordination between budgetary and monetary measures thus becomes essential.

The question was posed whether the Central Bank could reasonably be expected to contract credit sufficiently in a situation where the budget had the effect of expanding money supply as much as and even more than what could be

accommodated in a non-inflationary manner. Credit policy might even, in such a situation, need to provide for some degree of expansion so as to maintain productive activity. This means that while the Central Bank has continually to endeavour to advise the Government in these matters, the flexibility of credit policy was not unlimited.

The level of money supply for an economy and the rate of its increase were viewed as questions of basic importance. There was general agreement that the expansion in money supply has to bear a fairly close relationship to the growth in national product, if reasonable price stability is to be maintained. However, it was not easy to say to what extent this broad relationship should be modified to take account of short-term fluctuations. In several developing countries, the high variability of agricultural output from season to season complicates the problem. Very much depended on the safety valves in the system, the commodity stocks available, unutilized capacity, foreign exchange reserves, etc.

There might be need for variations in short-term interest rates. The long-term interest rate structure has to take into account, among other things, the requirements of development and the profitability of investment in the aggregate. The other weapons of credit control and relaxation need to be used in the light of each country's special circumstances. Stress was laid in this connection on the development of forecasting techniques. Instead of trying to react to a situation as it arose, the emphasis should be on anticipating likely developments and influencing them through timely appropriate measures.

Monetary planning and flow-of-funds analysis evolved in the specific context of each country can be helpful in facilitating rational decision making in the field of credit and monetary policies. This would depend on the availability of data and suitable personnel for the work. A monetary framework would provide a valuable cross-check for the various forecasts that are made in Government Departments. In this area, a Central Bank could play a useful role through statistical and research work that would seek to explain better the working of the monetary system and its impact on general economic activity.

All financial institutions and the Central Bank in particular are concerned with development and not merely with stability, although stability should receive simultaneous and continuous attention. This is because the absence of stability constitutes a danger to growth. Both development and stability are matters which cannot be achieved by financial institutions and Central Banks alone. It also depends on overall investment policy and the relation between investment and output.

The Central Bank should be continuously in dialogue with the other sectors of the economy to contribute to the realization of the objective of development with stability. The Central Banks should endeavour to build up lines of communications with Government on the one hand, and business and industry, on the other, in this regard. In the central banking field, there is need for improving the scope of public intelligence including technical documentation. The research publications of the Central Bank should be such as to produce an impact on the people, and this could be done if economic intelligence was also made intelligible.

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DR I.G. PATEL
Chief Economic Advisor

GOVERNMENT OF INDIA
MINISTRY OF FINANCE
DEPARTMENT OF ECONOMIC AFFAIRS
NEW DELHI
August 3, 1967

My dear L.K.,

This is more in the nature of the kind of loud thinking I would like to do with you if it were possible for me to come to Bombay.

2. We have been evolving the doctrine for some time that whatever scope there is for expansion of credit in the economy should be reserved, not for the Government budget, but for productive activity, whether public or private. I wonder, however, whether we have adequate institutional arrangements to make this possible. If money supply is to grow in keeping with the growth in production, it can happen only if the Reserve Bank is able to add to its assets from year to year. If an increase in assets in the form of Government securities is ruled out and if, as in our circumstances, an increase in foreign exchange reserves is also ruled out as not practicable, we are left only with an increase in those assets which represent the indebtedness of the private sector, including the financial institutions. As far as the private banking system is concerned, somehow, perhaps as a consequence of the absence of a proper Bill market, we have got into a situation in which although the Reserve Bank extends credits to the banking system during part of the year, this credit returns to the Reserve Bank in the remaining part of the year, so that from one year to the other, there is no increase in the indebtedness of the banking system to the Reserve Bank. It is true that the Reserve Bank, of late, has been financing the IDB and several institutions for agricultural credit. I wonder, however, if we do not need arrangements whereby the Reserve Bank financing of these institutions grows steadily from year to year rather than in a sporadic manner whenever new institutions are created and have to be capitalized.

3. One possibility would be for the Government to stop giving loans to IDB, etc. and ask these institutions to raise money in the market with heavy support by the banking system including the Reserve Bank. Similarly, in regard to agriculture also, perhaps arrangements could be worked out whereby the Reserve Bank would be willing to take securities floated, let us say by commercial banks, for the explicit purpose of financing fertilizer distribution or hire purchase for tractors and the like. In other words, the proper thing would be to shed a part of the load on the Government Budget and to pass it on to the Reserve Bank appropriately and in a manner which gives the Reserve Bank greater say in the credit policy of the institutions which it helps to grow from year to year.

4. At one stage, I was also toying with the idea that the financing of State Electricity Boards which is a major and growing activity should be taken out of the purview of the Government, and be put in the hands of a newly created holding company which will be responsible for finding the resources for the State Electricity Boards

and also for enforcing proper financial discipline on them. I understand that even today some of the public-sector enterprises which are well-established, find a part of their working capital requirements from the Government. At any rate, they find a part of their working capital requirements during the initial years from the Government by way of overcapitalization. Here again, the same institutional arrangements could be made whereby productive activities can find credit requirements not from the Budget but ultimately from the Reserve Bank through proper institutions.

5. Obviously, it is only the Reserve Bank which can expand credit overall and take a view about how much expansion should be allowed and in what sectors. Perhaps if such institutional arrangements are made, one could also have an institution like a Credit Council which would be serviced by the RBI. The credit requirements of different agencies could be ascertained and scrutinized and the Credit Council which would have representatives of the Reserve Bank, Ministry of Finance and the Planning Commission, would take a view about where more credit should be channelled and where less. In short, the kind of arrangement I am contemplating would pave the way not only for a reasonable expansion in money supply without deficit financing by the Government, but also for a more rational and coordinated credit policy in general.

6. You will, no doubt, be thinking about the Banks in the context of the AICC Resolution. The main problem, it seems to me, is that of ensuring two things: (a) that mobilization of deposits from all over the country should increase rapidly from year to year, and (b) that loans given from such mobilization topped up with whatever the Reserve Bank decides to put on it, should be made in accordance with a more carefully worked out overall plan of action. The intermediate stages of finding the right managers and training them, devising the mixture of incentives and disincentives and even deciding on who shall be the shareholders and who shall be the Board of Directors are, in my judgement, secondary issues as long as the two primary objectives are served. Whatever the solution adopted in regard to ownership, one will have to consider how these two objectives are to be ensured, and I am afraid we have not yet done enough thinking *de novo* on these questions.

With best regards,

Yours sincerely,
I.G. PATEL

Shri L.K. Jha
Governor
Reserve Bank of India
Bombay – 1

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Ref. DBOD.No.Sch.1236/C.96-67

RESERVE BANK OF INDIA
CENTRAL OFFICE
DEPARTMENT OF BANKING
OPERATIONS AND DEVELOPMENT
BOMBAY No. 1
POST BOX No. 1030
August 9, 1967
Sravana 18, 1889 (Saka)

To

All Scheduled Commercial Banks

Dear Sirs,

At a meeting which I had with the Chairman and/or Chief Executives of the larger Indian and foreign banks on 31 July 1967, I indicated to them the need for scheduled commercial banks enlarging their assistance to priority sectors like agriculture, exports, small industries and, in the context of the current recessionary trends, to the domestic engineering industries, especially those having export potentialities. To this end, I mentioned that the Reserve Bank of India and the Industrial Development Bank of India would introduce certain measures to facilitate an increase in the flow of commercial bank credit at lower rates of interest to these sectors. I enclose a Memorandum which sets out the measures which the Reserve Bank is now bringing into effect. A separate communication will follow regarding the steps to be taken by the Industrial Development Bank of India.

2. The point had been raised at the meeting referred to above that during the slack season, banks would find it more advantageous to use their own resources, currently earning less than the rate at which refinance is proposed to be offered by the Reserve Bank, to finance the sectors mentioned above rather than have recourse to the Reserve Bank. I had indicated that banks could approach the Reserve Bank for accommodation whenever they felt the need for such assistance in relation to their credit operations in respect of these sectors, but since the prime object of the Bank is to bring about a reduction in the level of interest rates charged to the sectors mentioned in paragraph 1 to the levels indicated in the Memorandum attached, the Bank believes that ceiling rates in respect of advances to these sectors should be observed by banks, irrespective of whether or not banks seek refinance from the Reserve Bank in respect of any of these classes of transactions on the concessional terms indicated above.

3. The question of relief in respect of the net liquidity ratio had also been raised at the meeting referred to above as it was felt that lending to the sectors mentioned above at the rates suggested would mean banks working on low differential margins and that the impact of making such advances even though refinanced at the rates indicated would otherwise be to lower banks' net liquidity ratio. It has been decided that for the purpose of computing the net liquidity ratio, the *increase* in a bank's advances to each of the sectors mentioned in the preceding paragraphs and those

in respect of small-scale industry which are guaranteed by the Credit Guarantee Organization over the average of such advances during the period July to October 1966 inclusive (for the slack season) and November 1966 to April 1967 inclusive (for the busy season) will not be taken into account. Whether a bank has any borrowing from the Reserve Bank outstanding or not, the rate at which it can borrow from the Bank will be determined as if an equivalent amount of advances had not been made. In view of the relief now being afforded in respect of the computation of the net liquidity ratio, banks should have no resource constraint in enlarging considerably the volume of their assistance to the sectors for which the concessional refinance terms are being offered.

4. As already indicated by me at the meeting, it has also been decided to exclude from the application of the norm (referred to in the Bank's letter DBOD.No.Sch.666/C.962-67 dated May 3, 1967) relating to the total of unsecured guarantees and unsecured advances, (i) packing credit advances, (ii) Export D/A bill advances, (iii) advances in respect of machinery supply bills which have been accepted by the purchaser's bank, (iv) advance to finance, on hire purchase or deferred payment basis, sales of machinery/equipment for agriculture, dairying or fisheries as well as of trucks/commercial vehicles, and (v) advances granted to exporters against their deferred receivables by way of cash subsidies, excise duty drawbacks, etc. Further, modifications in the policy towards unsecured advances will be announced when the Working Group now examining this question has made its recommendations.

5. A number of points relating to the distribution of banks' advances were also clarified at the meeting on July 31, 1967. It was made clear that the Directive issued last October requiring that not less than 80 per cent of the incremental advances in the busy season should be to industry and against export/import bills was no longer in force, and should not be invoked to restrict credit to any sector. As regards the current slack season, while banks should continue to effect a sizeable reduction in their credit against seasonal commodities in short supply, the advice contained in the Bank's letters to the larger banks in this regard need not apply to advances against raw jute, whether to mills or trade in view of the larger market arrivals of the new crop. Similarly, advances against sugar to mills and to the I.S.M.A.'s Export Division need not be subject to reduction beyond what is indicated by the releases ordered by Government. Advances against gur, however, need to be drastically curtailed.

6. In the face of a slowing down in the rate of deposit accretion and the emergence of heavy credit demands on the banking system, it is necessary to have purposive planning of credit expansion. Banks should keep in close touch with the Reserve Bank regarding their credit plans, both for the busy season and for the near future. Such contacts could also help to draw attention to cases where genuine productive activity may be hampered by lack of adequate credit.

7. I would like to take this opportunity of impressing upon banks once again the need to increase their assistance either directly or indirectly to the agricultural sector for production, marketing and development. It is proposed to discuss, in greater

detail, with representatives of commercial banks the manner in which they could enlarge their assistance to the agricultural sector.

8. Please acknowledge receipt.

Yours faithfully,
GOVERNOR

Encl: sheet

MEMORANDUM

The Reserve Bank is reintroducing with immediate effect the facilities of the Bill Market Scheme under Section 17(4) (c) of the Reserve Bank of India Act; the Scheme, for the present, will be restricted to the refinancing of credit granted to the sectors mentioned in the following paragraphs.

2. The Reserve Bank will be prepared to provide refinance, irrespective of a bank's net liquidity ratio, at a preferential rate of 4½ per cent per annum in respect of packing credit advances made by scheduled commercial banks to exporters of engineering and metallurgical products. This facility, which will be available in respect of both manufacturer-exporters and merchant-exporters, will be subject to the following conditions:

- (a) The bank's advance will carry a rate of interest not exceeding 6 per cent per annum.
- (b) There should be a firm export order or a letter of credit in favour of the domestic exporter. However, in special cases, and to take into account traditional trading practices in respect of certain export commodities, the Reserve Bank will be prepared, on a representation being made to it, to waive this requirement. Such waiver will be considered at the time of approving the bill limits in respect of these transactions.
- (c) The bills to be lodged with the Reserve Bank in respect of such packing credit advance should not be of more than 90 days' maturity. However, in appropriate cases, the Bank will be prepared to make one more fresh advance against a fresh set of bills.

3. The Reserve Bank will also be prepared to provide refinance, irrespective of a bank's net liquidity ratio, at bank rate in respect of packing credit advances made by scheduled commercial banks to exporters of products other than engineering and metallurgical. This facility, which will be available in respect of both manufacturer-exporters and merchant-exporters, will be subject to the following conditions:

- (a) The bank's advance will carry a rate of interest not exceeding 8 per cent per annum.
- (b) There should be a firm export order or a letter of credit in favour of the domestic exporter. However, in special cases, and to take into account traditional trading practices in respect of certain export commodities, the Reserve Bank will be prepared, on a representation being made to it, to waive

this requirement. Such waiver will be considered at the time of approving the bill limits in respect of these transactions.

- (c) The period of the packing credit advance to the exporter should not exceed 90 days prior to shipment in respect of any single transaction for which refinance is availed of.

4. Refinance will also be available to scheduled commercial banks, irrespective of their net liquidity ratio, at bank rate under Section 17(3A) of the Reserve Bank of India Act in respect of postshipment export bills denominated in currencies other than Indian rupees, and they will be expected to lend to their customers at a rate not exceeding 8 per cent per annum.

5. The Rupee Export Bill scheme will continue to operate as at present.

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D.O.No.G.8-67

Camp: Calcutta
August 10, 1967
Sravana 17, 1889 (Saka)

My dear I.G.,

I was delighted to get your D.O. No. CEA/1253/67 of 3rd August. I hope you will not think me unduly rash if I give a spontaneous response to your suggestion which is obviously borne out of a good deal of thought.

Quite frankly, your idea appeals to me. It would, I think, make for a good deal of streamlining of the system, but before any headway can be made, some thought has to be given to the quantitative implications both on the budget and on the RBI of the proposed change.

Further, it is important that the economic implication of such a change should be clearly understood. Obviously, we have to provide for an expansion in the monetary assets of the Reserve Bank to match the increase in reserve money needed to sustain the required monetary expansion. Implicit in your approach seems to be the thought that asset creation for a given money supply increase would progressively be smaller than now. At the same time, we have to guard against a monetary expansion which is well above the rate of real income growth even after allowing for a secular decline in income velocity. Such restraint I feel can be better exercised by making the RBI responsible for monetary expansion to take care of the working capital needs of all industry and agriculture whether in the private sector or the public sector, provided in the Budget deficit financing is fully eliminated. A transfer of certain financial obligations from the Exchequer to the Bank will not generate more resources for the economy, and it is specially important that the relief which the budget gets should not result in the amounts being spent in other ways. There has been a tendency in the past in each Plan to underestimate the requirements of working capital. There should be no assumption that because budgetary provisions will not be made for it, the working capital needs can be taken care of without any impact on the size of the Plan.

You have hinted at the possibility of having an institution like the Credit Council

which would be serviced by the Reserve Bank to help in bringing about a rational and coordinated credit policy. Clearly, the object of any such device would be to have some credit planning both dimensionally and directionally and in tune with Plan priorities. At my recent meeting with the bankers of which the minutes have separately gone to you, when I indicated to them the need for credit planning and for close consultation between the Reserve Bank and the banking system to discuss banks' resources position and the sectoral disposition of their assets' portfolios, I was vaguely groping towards an arrangement of this kind but confined to the present responsibilities of RBI. I am trying to bring into being an informal machinery for consultation and coordination of credit activities not only as regards commercial banking activities but as between these and the agricultural and industrial banking systems. However, if the orbit of operations is enlarged, it will clearly be necessary to introduce representatives of the Planning Commission and Finance Ministry as you have suggested in these deliberations.

As I have said, these are only first reactions. I should like to think over the matter further in consultation with my colleagues here.

I entirely agree with you about what the basic problem is in regard to the future of banking in this country. Here again, I would need a little time to think, but as Panandikar had promised at least a synopsis of his report before the Deputy Prime Minister goes to Japan, I was hoping to have a look at it before attempting an answer to the basic questions which you have posed.

As you have very rightly observed, it is much easier to discuss these things than to correspond about them. Why not make it a point to come to Bombay once a month? Anyway, I am planning to be in Delhi between the 26th and 28th.

Yours sincerely,
L.K. JHA

Dr I.G. Patel
Chief Economic Advisor
Ministry of Finance
Department of Economic Affairs
Government of India
New Delhi

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MINISTRY OF FINANCE
DEPARTMENT OF ECONOMIC AFFAIRS

Regarding Shri R.K. Hazari's note dated 6.1.1971 which Seshadri handed over to me this morning, Government do not propose to interfere in whatever the Reserve Bank considers the appropriate course of action under the circumstances. We presume, however, that:

- (a) changes in deposit rates will be announced simultaneously with other changes;

- (b) the question of a commitment charge on advances to Food Corporation would not be linked up with the changes at this stage;
- (c) on an average, the rate on advances given by commercial banks will not increase by more than 1 per cent.

2. It is for your consideration whether action could not be taken tomorrow itself rather than waiting till Saturday.

3. It is important that in giving any publicity, the positive aspects of deposit mobilization, continuance of priority treatment for the priority sectors and timely action to check undue credit expansion and price rise are emphasized. You will, no doubt, agree that publicity which might lead to much more meaning being read into the action cannot be desirable under any circumstances. Nor is the action proposed such as to give an impression that it is intended to deal with a very serious situation.

Governor, RBI

I.G. PATEL
7.1.71

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CENTRAL BANK OF INDIA
BOMBAY -1
31st January 1973

My dear Hazari,

You will recall the discussions in Delhi about transfer of accounts. To the best of my recollection, it was decided that there should be a complete ban on transfers of accounts for a period of three months, regardless of whether the limits involved are more or less than Rs 25 lakhs. Since the Reserve Bank circular of 13th January 1973 imposing certain restrictions on transfers of accounts involving limits of Rs 25 lakhs and over was published in the newspapers after the above decision was taken, there is scope for misunderstanding as to whether the ban on transfers of accounts applies only to such limits. I have, therefore, to request you to kindly advise banks to ensure that they do not take over any accounts for a period of three months. You will appreciate that even when transfers of accounts are disallowed, big borrowers will continue to take advantage of inter-bank competition to secure lower rates of interest on new accounts, so that the current instability in this matter will continue, and the pressure for reduction of rates on old accounts will remain unabated. The pressure for lower rates is exercised by the borrowers in the public sector, no less from those in the private sector. Further, where a party has borrowing arrangements with several banks, and this is the case with many large borrowers, a divergence in the rates of interest charged by the banks concerned leads to the limit bearing the higher rate of interest being utilized to the minimum extent. Both these problems can be dealt with only by the Reserve Bank of India prescribing a minimum rate of interest for certain categories of big borrowers. Since the Reserve Bank has laid down rates of interest payable on different categories of deposits, it would be reasonable to fix a minimum rate of interest on at least some categories of advances. This would

safeguard the profitability of banks which is currently threatened by excessive competition among them in this respect.

I shall be grateful if the Reserve Bank would give a speedy decision in this matter. If the Reserve Bank is in favour of free competition among banks in the matter of interest rates, they may make this clear, so that banks will thereafter consider themselves free to quote competitive rates, subject to the Reserve Bank's conditions about liquidity and the individual banks' own assessment of the overall impact on their profits.

Each bank has to safeguard its profitability by maintaining an optimum credit–deposit ratio, because it is constantly adding to its deposits and consequently to its interest burden, and also incurring development expenditure. The responsibility for this rests primarily with the bank itself which must maintain a constant awareness of the way a decline in profits will affect its ability to build up its reserves, to perform its development functions and to carry out its obligations to its customers and employees.

Today each bank is trying to improve its credit–deposit ratio more or less in ignorance of the interest rates actually charged by its competitors. It is for the Government and the RBI to consider: (a) whether the data available to them (or which under a system of nationalized banking should be available to them) about the rates actually charged by SBI and different nationalized banks should be shared with the banks and suitable guidance given to them, or (b) whether, in the absence of such data and such guidance, the banks should be left free to adjust their rates on the basis of such information as they are able to gather from their field offices about the competition offered by other banks, or (c) whether the banks should be restrained from acting on their own information (as some banks are at present) and should, at the same time, be denied the information available to the authorities about the rates actually charged by major banks. There is obviously some fairness in (a) or (b), but (c) would be quite unfair.

Neither a permanent ban on transfer of accounts (which, as stated above, does not touch the problem arising in cases where parties maintain accounts with different banks which charge different rates, or the one arising in respect of new accounts) nor the procedure of prior consultation or clearance provides a satisfactory solution. You will appreciate that a bank which seeks to deny a valued customer with whom it has built up a relationship over a long period of years, the benefit of a lower rate he expects to get from another bank is bound to incur his displeasure, especially when it seeks outside intervention in this matter or discriminates between an old customer and a new one to whom it readily offers a competitive rate for fear of losing his custom. A commercial bank cannot afford to strain its relations with its customers without good reasons. A party may be stopped from transferring its account, but nothing can stop it or its associates from transferring deposits or its inland or foreign bill business (which is often very remunerative) to another bank or from giving the bank a bad name in the business community for its obstructive or discriminatory attitude. Banks would have less practical difficulties if these commercial policy considerations could be kept in view.

I am sending a copy of this letter to the Department of Banking (Mr Bhide) for

information, as the question has remained pending in my Board for quite some time.

With kind regards,

Dr R.K. Hazari
Deputy Governor
Reserve Bank of India
Bombay

Yours sincerely,
B.N. ADARKAR

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N.C. Sen Gupta
Secretary

MINISTRY OF FINANCE
DEPARTMENT OF BANKING
'JEEVAN DEEP' PARLIAMENT STREET
NEW DELHI
22nd December, 1973

My dear Jagannathan,

We discussed in Calcutta the possible impact of the current credit restrictions on the banks' advances to priority sectors. You agreed that the priority accorded to the designated sectors should continue to be observed fully. As you know, at present, roughly 24 per cent of banks' lending go to these priority sectors. There should be no reduction in this percentage, but progressively the percentage should be increased so as to cover 33.3 per cent. I find that the instructions issued by the Reserve Bank (No.Sy.24-2087 dated December 11, 1973) do not refer to the priority sectors. Perhaps, a classificatory circular would be useful.

Yours sincerely,
N.C. SEN GUPTA

Shri S. Jagannathan
Governor
Reserve Bank of India
Central Office
Bombay 1

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D.No. No. 127-SEA/74

Secretary

MINISTRY OF FINANCE
DEPARTMENT OF ECONOMIC AFFAIRS
NEW DELHI
January 5, 1974

My dear Jagannathan,

At the meeting the other day in FM's room, you were sympathetic to the question of ensuring that the export sector is not discouraged in the context of the credit

squeeze, nor the reins in this particular area pulled too tight. We also have an oil squeeze, and in this context the need to encourage exports becomes even more compelling.

2. In this context, I enclose an extract from a note which I have received from Tirumalai on the subject. I had asked him to let me have it before the meeting with FM the other day. Unfortunately, it turned up when the meeting finished. It is prepared somewhat hurriedly, but it puts across the message. In any case, discussions with the Ministry of Commerce to get into more detail in regard to the various difficulties experienced by exporters can easily be arranged should you think this useful.

3. The note particularly mentions the need for packing (or is it packaging?) credit which was also brought up at the meeting. This theme has come up repeatedly. There is also the question of banks being able to discount pay orders relating to export credits, excise drawbacks, duty drawbacks, et al. This particularly affects the smaller exporters.

4. I shall be very happy to hear from you about any steps taken by RBI in regard to the export sector generally. If the Finance Ministry can help in any way in this matter, we shall be very glad to do so.

5. Incidentally, I have not yet heard from you about the Cotton Corporation. The note of the Commerce Ministry on the subject approved by their Minister, I handed over to you in Calcutta. This is still with you. We would also like to know your thinking on jute in this same context of bank credit. Jute never came up at the FM's meeting.

With kind regards,

Yours sincerely,
M.G. KAUL

Shri S. Jagannathan
Governor
Reserve Bank of India
Central Office
Bombay

My dear Kaul,

You will recollect leaving with me a note containing an analysis of expansion of bank credit during the current busy season. In this connection, I request you to see also the note prepared in the Reserve Bank which is mainly confined to making certain observations on the concluding portions of the note that you left with me.

You had mentioned that you had not seen the article published in the Reserve

Bank Bulletin regarding the evolution of Reserve Bank's credit policy. I enclose for your retention a reprint of the article in question.

With kind regards,

Yours sincerely,
S. JAGANNATHAN

Shri M.G. Kaul
Economic Secretary
Ministry of Finance
Government of India
New Delhi

(P.S. You had referred, in your conversation with me, to some article in *Economic and Political Weekly*. In case the article that you had in mind was that bearing the heading 'Dear Money, Indeed' in the issue dated 23rd March 1974, I may mention that the article is based on a misapprehension and, to add to this, has been based on a totally incorrect figure assumed to be Rs 4615.8 crores, when in fact the correct figure is Rs 461.58 crores. I enclose for your information a copy of the letter that has been sent to the Editor explaining our points. In case you think that FM has read this article also, you may kindly show him the correction.

You would not have missed the point that the series of measures that we took for increasing the cost of money to the banks began only in November 1972 and, more significantly, in March and May 1973. The article discusses 1972 statistics, and therefore is not to the point at all as to the effect of our 1973 measures.)

S. JAGANNATHAN

NOTE 2

It is said that even allowing for the special nature of certain credits that have been sanctioned such as for oil companies, public sector undertakings, etc., the overall picture is still one of a higher level of bank credit expansion than what the Reserve Bank earlier considered warranted. The *total* expansion of credit is as has been stated, and the facts to be clarified are the extent and special nature of certain credits. The fact is that credit extended after sanctioning to public sector undertakings during the current season has been much larger than in 1972-73 busy season. As against a total expansion of about Rs 86 crores during the six-month period—end-October to end-April 1973, credit to public sector undertakings rose by Rs 38 crores in October 1973, and by Rs 76 crores in the following two months or by Rs 114 crores in all, in just three months. According to preliminary information available, credit to the public sector undertakings is likely to have maintained this monthly order of expansion. Therefore, if credit given to public sector undertakings as well as to the export sector are excluded from total bank credit, bank credit expansion to private sector (for other than export) would not turn out to be very much different from what was considered warranted by the Reserve Bank.

The note has not mentioned the point that the flow of credit to the priority sectors has also been higher than in the preceding season. Here again, the increase in credit was Rs 145 crores during the three-month period—October, November

and December 1973, which was far higher than the total expansion of Rs 88 crores in the corresponding period of three months of last year.

In the light of the order of credit expansion and the sectoral components indicated above, it would have been appreciated and this is the fact to be kept in view that the credit expansion has been permitted with the knowledge of the Reserve Bank. The assistance provided by the Reserve Bank will have to be viewed against the order of expansion considered reasonable and the quantum of resources which the banks themselves could raise. As a result of the impounding of additional reserve requirements in June and again in September, something of the order of Rs 350 to 400 crores had been siphoned off. At the same time, the deposit growth turned out to be smaller, that is, Rs 430 crores between end-October 1973 and 22 March 1974 or by 4.5 per cent as against Rs 562 crores or 7.1 per cent last year. Refinance was provided to banks only after detailed discussions with each one of them about their funds' position and sectoral pattern of deployment. Similarly, rediscounts under the bills' rediscounting scheme have also been provided after detailed discussions and scrutiny.

The following figures relating to refinance may be noted in this connection. As of March 30, 1974, total refinance provided by the Reserve Bank stood at Rs 423 crores. The break-up of this under various heads will be as follows:

1. 2 per cent of DTL	Rs 212 crores
2. Special refinance for Oil Companies (as a result of rise in imported crude prices)	Rs 14 crores
3. Special refinance for food procurement	Rs 27 crores
4. Special refinance related to exports	Rs 92 crores
Total	<u>Rs 345 crores</u>
Balance provided by way of discretionary accommodation mainly to help finance public sector undertakings	<u>Rs 78 crores</u>
Grand Total	<u>Rs 423 crores</u>

It is mentioned in the note that to the extent to which non-bank financial institutions are in the market for participation certificates, and the extent to which LIC operates in the call market, the ability of banks to extend credit has increased. During the current busy season, there has been hardly any increase in the funds made available by the LIC and UTI (the total funds from which made available to the banks stand at about Rs 48 crores at present). Although figures are not available, total amount raised from non-bank institutions on a participation basis is not very large.

It mentioned that in the type of credit situation that has prevailed in the last few months, the banks have virtually been approaching the Reserve Bank as a lender of the first resort. This view is not factually correct. To the extent resources could be tapped from non-banking institutions such as LIC and UTI, banks have made use of them and resorted to the Reserve Bank only after. However, as pointed out earlier, the additional resources available to banks from non-bank institutions was not significant. A further point to be considered is that if LIC and UTI had gone off the market completely, the Reserve Bank would have provided more accommodation

to banks given the judgement that the order of credit expansion was something which could be justifiably supported. The monetary impact of such larger Reserve Bank assistance would have been more expansionary.

Reserve Bank of India
Bombay
April 3, 1974

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D.O.No. 6928-CS/74

CABINET SECRETARY
NEW DELHI
12th August, 1974

My dear Kaul,

I understand that a Committee has been set up consisting of Additional Secretaries of two or three Ministries and a representative of the Reserve Bank of India to work out certain details of credit policy. I also understand that there is a Committee or a group of bankers to study this question. I have been told of a few problems which I am requesting that these Committees may take into consideration when formulating their views.

The first relates to the review of the top 25–50 accounts in each bank. It has been mentioned that this will operate differently in different banks, and it may be therefore desirable to lay down a credit limit up to which the accounts will be reviewed in each bank, which may be, say, Rs 1 crore or Rs 5 crores as may be considered appropriate.

Secondly, it may also be desirable to lay down certain guidelines with regard to the availability of credit for essential production programmes specially in the core sector, like power, fertilizers, commercial vehicles, scooters or articles of mass consumption and essential articles subject to whatever limitations are needed to prevent profiteering, hoarding, etc.

Doubtless, the committees will be considering these matters, but I am bringing these for your consideration. It may also be desirable to associate in the discussions representatives of the more important Ministries concerned in this programme like the Ministry of Heavy Industry, Industrial Development, Steel and Mines, Petroleum and Chemicals, etc.

Yours sincerely,
B.D. PANDE

Shri M.G. Kaul
Secretary
Department of Economic Affairs
New Delhi

D.O.No. 1561-174

August 16, 1974

Dear Shri Pande,

Kindly refer to your D.O. No. 6928-CS/74 dated 12th August, 1974 about credit policy. Two groups have been formed as desired by FM. One group is meant to look into problems of credit to public sector enterprises. The second group performs the same function for credit to the export sector. Narasimham, Additional Secretary in this Department and Balasubramanian, Additional Secretary in Banking are members of both groups. A.P.V. Krishnan, Additional Secretary in the Ministry of Finance (Dept. of Expdr.) and R. Tirumalai, Additional Secretary in the Ministry of Commerce are associated with the group on exports and Fernandes with the group on public sector enterprises.

2. I would like to say here that the guidelines in regard to availability of credit from banks are laid down by the Reserve Bank, because it is the Reserve Bank which is responsible for laying down and administering the policy aspects of such credit. The groups mentioned above will look into the manner in which the policy laid down by the RBI is affecting the sectors concerned, and where necessary changes are called for, we will bring the findings of the groups to the notice of the Governor, Reserve Bank.

3. I am also sending the Governor the suggestions you have made in regard to the review of the top 50 accounts in each bank, and availability of credit for essential production programmes.

4. In this context, you may be interested to see copy of a letter that I have recently written to the Governor, RBI on the subject of the policy regarding credit restraints.

With kind regards,

Shri B.D. Pande
Cabinet Secretary
New Delhi

Yours sincerely,
M.G. KAUL

Copy to:

1. Governor, RBI, Bombay.
2. Secretary, Department of Banking, New Delhi.
3. Secretary (E).

M.G. KAUL
16.8.1974

Informal note prepared after discussions with Shri P.N. Dhar on 15.9.74, before discussions with PM.

16.9.1974

In consonance with the national policy of fighting inflation, aggregate credit expansion in 1974–75 will have to be restricted to a level, and a rate of growth, somewhat lower than in 1973–74.

Consequently, not all of the borrowers even in the priority categories, are likely to be fully provided by the banking system.

Specifically, this will require restraint in provision of credit, direct and indirect, to borrowers who could contribute to maintaining high prices or pushing them to unjustifiable levels. Since only a limited amount of commercial bank credit is provided directly to agriculture, principal points of action arise in: (a) supply of credit through cooperatives and (b) supply of credit to the marketing agencies and/or processing industries. Some of the important elements in such action consist of the following:

1. *Cooperative Credit*

Overdues have continued to accumulate and explicit measures have to be taken not only to stop this tendency but to speed up recovery of past dues. This is largely a matter for the states to implement. In terms of national policy, this will imply restraint on the supply of credit to cooperatives, both from the Reserve Bank of India and the commercial banks.

2. *Redefinition of Priority Sector*

In respect of both agriculture and small industry, the criteria for provision of credit on a priority basis should be more strictly defined than at present. This is necessary to prevent undue appropriation of available credit by big farmers or the bigger units in the small-scale sector. Some steps have already been taken in this regard and these will have to be strengthened.

3. *Marketing Credit*

- (a) *Cotton*: Cotton prices are at present very high. This affects adversely both exports and domestic consumers. It is necessary that commercial bank credit is not used by marketing agencies, irrespective of whether they are in public, private or cooperative sectors, to keep prices at an artificially high level. Hence, the access to bank credit by such agencies will have to be reduced.
- (b) *Jute*: The crop prospects are such that no large-scale intervention in the market by the Jute Corporation of India is necessary to maintain prices. Likewise, it is not necessary to require jute mills to hold substantial stocks of raw jute as was necessary last year. Hence, allocation of bank credit for marketing of jute has to be on a smaller scale than in the previous year.
- (c) *Sugar*: Bank credit is provided to the sugar industry, largely to ensure that payments to cane growers are not withheld because of the Government's

policy regarding releases of sugar by the mills. Currently, the credit extended to sugar industry is not being repaid despite large realizations from exports and high prices of free market sugar. In this context, it is necessary that Government authorize a larger release of levy sugar. This will benefit the domestic consumers, and at the same time reduce the sugar industry's draft on bank credit.

- (d) *Credit for public food procurement*: At present, bank credit is used both by the Food Corporation of India and by State Governments and their agencies, particularly Punjab and Haryana. This has come in the way of efficient management of food stocks on the basis of national considerations. In fact, state agencies have tried to finance stock building operations by using bank credit, despite shortages in the rest of the country. This has to be prevented by ensuring that Central control on food stocks is made effective. For this purpose, provision of bank credit to State agencies which are not functioning principally as agencies of Food Corporation of India will have to be restricted.

4. *Financing of Petroleum Products*

In the last eight months, substantial credit has been provided to the oil refining and marketing companies, both in the public and private sectors to bridge the deficiencies in cash inflows pending the adjustments in petroleum product prices, consequent on the higher price on crude. This situation should not be permitted to become a permanent feature of credit allocation. It is understood that the need for such credit will soon be obviated through appropriate adjustments in the prices of petroleum products.

5. *Priority Allocations*

It is the purpose of credit policy to accord preferential treatment to exports, industries in the core sectors and essential consumer industries like controlled cloth. However, in all of these, bank credit will be available for financing normal working capital. Bank credit should not be used for unnecessary build-up of inventories, financing of fixed assets, or for covering continuing operational losses. These criteria are, as a matter of course, applied to private sector units. It is necessary that similar discipline is brought to bear upon public enterprises, and the banking system is not compelled to afford special treatment.

The contents of the note on Monetary Budget for 1975-76 and Busy Season Credit Policy for 1975-76 Busy Season, prepared in the Reserve Bank of India, were discussed with the Government as under: (1) Preliminary meeting with Finance Ministry officials (Shri M.G. Kaul, Shri N.C. Sen Gupta and Dr Manmohan Singh)

on 23.10.1975; (2) First round of discussions on 24.10.1975 with Shri C. Subramanian, Finance Minister when Shri P.N. Dhar, Shri H.N. Ray, Shri M.G. Kaul, Shri N.C. Sen Gupta, Dr A. Mazumdar, Shri M. Narasimham, Dr Manmohan Singh and Shri G. Ramchandran were present; (3) Discussions on Monetary Budget on 24.10.1975 in the light of revised budget deficit with Dr A. Mazumdar, Shri M. Narasimham, Dr Manmohan Singh, Shri K.N. Rao and Shri Iswaran; and (4) Final round of discussions with the Finance Minister and Ministry officials. From the Reserve Bank, the following were present: (1) Shri K.R. Puri (Governor), (2) Dr R.K. Hazari (Deputy Governor), (3) Dr K.S. Krishnaswamy (Executive Director), and (4) Shri A. Raman (Advisor).

I

In the preliminary meeting (Item No. 1 above), Shri M.G. Kaul mentioned that the Government had taken a decision that all operations of food and fertilizer procurement and distribution, except the subsidization provided in the Central Budget, should henceforth be handled by the commercial banking system. He agreed that this did involve financing of buffer stocks, which was hitherto regarded as budgetary responsibility, but that there was a 'change in theology'. Dr Hazari pointed out that financing of buffer stocks would be the equivalent of long-term investment and would ultimately become permanent financing by the Reserve Bank (as a substantial part of food procurement credit extended by banks is refinanced by the Reserve Bank); this would cut into the other investment obligations of both the Reserve Bank and the commercial banks.

Dr Manmohan Singh stated that there could be some more liberalization on export credit.

II

Initiating the discussions with the Finance Minister (Item No. 2), Dr K.S. Krishnaswamy said that in several areas in the industrial sector, there was a lack of demand. Investment was not accruing at the rate at which it should. There was a good deal of discussion on the cotton textile situation, but it was agreed that adjustment of excise duties was not a solution. The quality of controlled cloth had improved, and some relaxation in distribution of controlled cloth was desirable to help move stocks faster. Another solution to the cotton textile situation was also an adjustment in selling prices. There was a general consensus that the reduction effected, so far, in prices of cotton textiles was not commensurate with the fall in cotton prices.

Dr Krishnaswamy also referred to the prospects of accumulation of steel and coal, and both Dr Hazari and Dr Krishnaswamy suggested some selective encouragement in demand for steel. The outlook for world steel industry being bleak, export prospects were not encouraging. Dr Hazari mentioned the scope for lifting the bank on construction activity and for more railway orders for wagons.

Dr Krishnaswamy added that while there was no general recession of demand, it was worthwhile promoting demand selectively in respect of some engineering industries left with stocks. Private investment was likely to remain subdued and in

other areas, Government may have to consider larger investment. The more recent projects expect term-lending agencies to provide more funds, their equity participation being less than what it should normally be.

Dr Krishnaswamy said that in the context of this overall situation and when prices have not shown any significant trend downwards, we have to exercise caution in formulating our policy. He recalled the earlier discussions in June with the Finance Minister when the feeling was that on a 5–6 per cent increase in real output, the increase in money supply could not go beyond 7.5 per cent. During the current financial year thus far, money supply had already arisen by 4 per cent and taking into account the likely demand for credit in the coming months, a target of 7.5 per cent increase was no longer sustainable. He then gave details of monetary and credit projections on the basis of a 10.4 per cent increase in money supply (as given in the technical paper appended to the note). Dr Krishnaswamy added that in the context of the bumper Kharif crop of both foodgrains and commercial crops, the projected increase of 10.4 per cent would probably leave prices unaffected for the next few months. The level of money supply at the end of the fixed year 1975–76 would be higher than what was envisaged earlier, and this factor was to be taken into account while assessing the prospects of price stability in 1976–77. However, assuming a good rabi crop and some increase in industrial aspect, an increase in money supply of about 10 per cent could perhaps be tolerated, and could leave enough flexibility to operate monetary and fiscal instruments next year.

The Finance Minister wanted to know whether the projected increase in credit (Rs 1,900 crores to commercial sector) would help contain buffer stocks of commodities at levels indicated. Dr Krishnaswamy explained that the projected increase in credit provided for an expansion of Rs 250–300 crores for food procurement operations during the ensuing busy season period on the assumption that any 'buffer stocks' at end of March 1976 would be financed from budgetary resources. It had also taken into account the need to provide some support to raw cotton prices but not items like monopoly procurement of cotton by Maharashtra, which the Reserve Bank did not consider a viable one. A part of the requirements of the Maharashtra scheme would be met by the banking system. Regarding cotton, a point was made that mills had the barest minimum stocks—2 weeks or so—and if they could be asked to stock up to 4 weeks, there would be a favourable impact. No price support was assumed for oilseeds, nor would the Reserve Bank advise it.

The Finance Minister observed that *all* transactions of a commercial nature relating to food and fertilizer operations will have to be isolated from the Budget and financed by banks. He did not distinguish, in this context, between trading stocks and buffer stocks, as seemed to be the practice so far. Regarding cotton operations, he mentioned that it will not be on the same footing as food operations and only marginal price support could be thought of. He added that we should be clear as to what sort of operations will be financed by the commercial banks and that the Cabinet should be apprised of its implications (in a note to be submitted to the Cabinet). He suggested an immediate detailed exercise to be undertaken to work out the implications of taking over of additional food and fertilizer operations

by the banking system on bank credit to Government (Rs 1,150 crores) and on bank credit to commercial sector (Rs 1,900 crores).

Dr Hazari then outlined the broad features of 1975–76 busy season policy finalized by the Reserve Bank. He mentioned that the basic stance of tightness was to be maintained while providing for June flexibility in certain directions. In view of the benefits derived from the present structure of interest rates, there would be no change in this regard, except for item (3) below. Some of the specific points mentioned by Dr Hazari included: (1) subsidy on export credit should be raised from 1.5 to 4 per cent for deferred payments (also buyers' credits) and from 1.5 to 2.5 per cent for other exports; (2) IDBI's assistance in 1975–76 will have to be larger; (3) commercial banks will be advised to charge not more than 15 per cent (14 per cent if Government were prepared to withdraw the tax on interest income) on term loans for a period beyond three years; (4) minimum margin on cotton textiles to traders, dealers, etc. would be reduced from 40 to 25 per cent; (5) banks would be advised to fix a lower margin on controlled cloth; (6) some minor modifications in selective controls on oilseeds and rice mills will be made in margins (from 75 to 60 per cent for oilseeds and from 45 to 35 per cent for rice mills); and (7) the policy did not provide for buffer stocking of cotton but allowed some bridging finance for the Maharashtra Scheme.

III

The main point which emerged during discussions with the Finance Ministry officials on the afternoon of 24th October (Item No. 3) was that the Government budgetary deficit would show a considerable deterioration from the original figure of Rs 247 crores envisaged in the Budget. The budget deficit that is now anticipated is of the order of Rs 860 crores. Although budgetary receipts will show a net improvement of Rs 650 crores over the budget estimate, there will be an increase of Rs 274 crores in plan expenditure and of Rs 720 crores in non-plan expenditure. Added to this will be additional subsidy payments of Rs 100 crores on account of fertilizers. To this figure will have to be added the shortfall in payments by the FCI (Rs 80 crores) and the likely non-payment by Bihar (Rs 30 crores) to the FCI.

The net effect of the Government's proposals as to increase the net bank credit from Rs 1,150 crores to Rs 1,470 crores and of the credit to the commercial sector from Rs 1,900 crores to Rs 2,300 crores as a result of providing an additional Rs 200 crores for food and an additional Rs 200 crores for fertilizer.

IV

A note prepared in the light of the discussions and presented to the Finance Minister is appended. The revised projections indicated an increase of 14.9 per cent in money supply. This note was discussed on the 25th with the Finance Minister (Item No. 4).

Dr Hazari expressed the Reserve Bank's view that an increase of 14.9 per cent in money supply was disturbing and unsafe. The Finance Minister asked for suggestions for bringing down the growth of money supply. Dr Hazari stated that decisions on suggestions in this regard would depend on Government's judgement. The Governor observed, in this context, that there seemed to be scope for reducing food subsidy

(by an adjustment in issue price). He also pointed out that any reduction in fertilizer prices would worsen the budget deficit (subsidy becoming larger). The Finance Minister observed that apparently, containment of monetary expansion to a lower rate would require the exercise of greater budgetary control henceforward. During the discussions, the point also came out that the scope for phasing investment in public and private sectors should be explored. It was noticed that the projected order of increase in money assumed an increase of over 14 per cent in bank credit to Government, would be in excess of the figure of 12.4 per cent, indicated to the IMF. If food and fertilizer transactions now proposed to be transferred to banks are also reckoned with, the increase in bank credit to Government would be larger than 14 per cent.

Dr Krishnaswamy made the following observations. Even allowing for the growth in real output of 5–6 per cent this year, and the availability of larger stocks at the beginning of the next financial year, a 15 per cent increase in money supply this year could mean a revival of expectations of price increase in the ensuing period. This would reverse many of the trends in the economy which, in the past few months, had contributed to stability. The inflationary danger for the coming year would be more, if along with a step up in investment expenditure, there was a further accumulation of food stocks. He added that in the context of the national policy of building buffer stocks *and* stepping up investment, it was inevitable that energetic measures had to be taken for raising domestic savings. Any revival of inflationary tendencies in the economy would make it virtually impossible to generate larger savings in the household sector. He observed that savings in the public sector was unsatisfactory and unless public enterprises avoided losses and actually generated surpluses, the problem would get greatly compounded over the years.

The Finance Minister observed that taking into account the health of the economy, if expansion in money supply of the order of 15 per cent is considered inflationary, we should explore all measures of controlling expenditure and raising larger investible resources. Dr Krishnaswamy said in the meeting with finance ministry officials, that it had been indicated that the scope for cutting down spending was limited; hence the only solution seemed to be to raise larger resources. In this context, Centre's assistance to States may have to be kept down to reduce the burden on the Central budget. While creating, at the same time, pressure to mobilize larger resources, in the State's sector, especially from agriculture State Road Transport Corporations/Electricity Boards. There also has to be rigid control on commercial bank credit and the interest rate structure has to be maintained as, at present, to assist this process. While every assistance has to be given to raising production through credit policy, care has to be ensured that no increase in money supply takes place to facilitate addition to inventories. Shri H.N. Ray also raised the point at this stage as to why there should be continuation of massive subsidy on food in the budget.

The Finance Minister desired that we should study all possible advances for bringing down the projected rate of increase in money supply of 14.9 per cent—cut in spending, raising of more resources or other methods.

The Finance Minister was in agreement with the features of 1975–76 busy season credit policy as outlined by Dr Hazari in the earlier meeting held on 24.10.1975.

A. RAMAN
October 27, 1975

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Ref. D.O.No.CPC.302/1313/75

December 3, 1975
Agrahayana 12, 1897 (Saka)

Dear Dr Saxena,

This has reference to your D.O. letter No. 81–JS (DEV)/75 of October 28, 1975 forwarding a copy of Shri T.A. Pai's letter to the FM regarding interest cost of industries.

As Government are aware, our interest rate policy is based on a number of considerations; to provide some incentive for savings, to discourage excessive inventories of goods and other physical assets, and generally to induce a more rational application of scarce funds—long-term as well as short-term. These objectives continue to be relevant and we are of the view that under present circumstances, it does not seem advisable to make any basic change in the structure of interest rates.

The climate of price inflation combined with the inadequacy of returns on financial assets like bank deposits had, until recently, shifted people's preferences to real assets—gold, real estate and goods. The higher deposit rates—5 per cent for savings deposits or the maximum of 10 per cent on term deposits have remedied this to some extent. It is important that this trend is not reversed by reducing interest rates on deposits.

With the changing mix of deposits and the higher cost of refinance from the Reserve Bank, the average cost of funds for the banks has gone up. Thus, as may be observed from the Table appended, the average of interest paid on 'working funds' by twenty-two public sector banks shot up almost by a full percentage point from 3.594 per cent to 4.534 per cent in 1974. In 1975, it would be still higher.

On the other hand, banks' 'establishment expenses' (including bonus), which as a proportion of the 'total working funds' has, by and large, remained stable during the past four years, 1971–74. There was some spurt in 'establishment expenses' (including bonus) in the first two years (1970 and 1971) of the nationalization of fourteen major banks, following a fast and sizeable expansion in branch network.

On the earnings side, about two-thirds of bank funds are pre-empted by low or negligible yielding assets: cash and reserves with RBI, pre-emptive investments in Government and other approved securities and the financing of a series of priority sectors (including small-scale industrial units with credit limits not exceeding Rs 2 lakhs), which stand exempted from the minimum lending rate prescribed by the Reserve Bank of India. Only 1 per cent out of four of total liabilities kept as reserves with RBI earns interest of 5.5 per cent. Investments in treasury bills fetch 4.6 per cent and those in Government and other approved securities around 6 per cent.

Thus, all of these earn less than the average cost of funds to the banks. Besides, because of the concessional rates charged to small borrowers in different priority sectors, about 50 per cent of the bank credit was given at rates below 11 per cent in June 1974 (when the minimum lending rate prescribed was 11 per cent). Even for the non-exempted categories of medium-scale and large-scale borrowers, the commercial banks adopt industry-wise and purpose-wise priorities in charging interest rates. As a result, the spread between 'interest paid on deposits and borrowings' and 'total earnings', each as percentage of 'total working funds', cannot be said to have risen disproportionately.

There are also some wider considerations in framing the interest rate policy. First, the interest cost forms a small part of the value of output—generally ranging from 2 to 4 per cent in different industries. Secondly, with better inventory management for which there is considerable scope, interest burden to industries should be lower than what the increase in the nominal rates suggests. A *quick* study of the finances of 226 public limited companies in the private sector shows that despite the sharp increase in interest rates, interest cost as a percentage of value of output increased just nominally from 2.6 per cent in 1973–74 to 2.7 per cent in 1974–75. Thirdly, the incidence of even this nominal interest rate gets further reduced as interest cost is a deductible expenditure for tax purposes; hence as much as 45 to 50 per cent of the interest cost is borne by the Government. Fourthly, the policy of low interest rate had created distortions in the use of short-term and long-term funds—larger inventories, general laxity in cost consciousness, substitution of capital-intensive technology replacing labour even in areas where economies of scale do not call for such substitution and the like. Lastly, the increase in the rate of interest for large borrowers is an important safeguard against such borrowers pre-empting bank credit disproportionately to their requirements, and thus reduce the availability of credit for small borrowers.

It is wrong to consider the current recession as the one requiring a relaxation in interest cost, particularly in regard to lendings by the commercial banks—a substantial proportion of which is for inventory financing. To the extent the commercial banks give term loans, the recent advice by the Reserve Bank to keep the term loan rates at around 15 per cent will further benefit the investors. Even the withdrawal of commitment charges on unutilized portion of credit limits will tend to reduce the interest burden.

The system of charging interest at monthly rates is not widespread; the general practice is to charge it on a quarterly basis. We are also advising the banks to discontinue the practice of charging interest at monthly rests, wherever it exists.

With regards,

Yours sincerely,
K.S. KRISHNASWAMY

Dr D.N. Saxena
Joint Secretary
Ministry of Finance (Department of Banking)
Government of India
New Delhi

April 30, 1976

My dear Manmohan,

When I telephoned to you yesterday afternoon to indicate the measures Governor intends to announce at his forthcoming meeting with bankers at Calcutta on May 7, you informed me that Economic Secretary desires that such communications from the Reserve Bank should be in writing. Hence this letter.

As you may be aware, at his meeting with the bankers on March 12, 1976, the Governor had agreed to meet with the bankers again at the beginning of the traditional slack season. In pursuance of this, we have invited the principal banks in the public and private sectors to a meeting to be held in the Reserve Bank of India, Calcutta on May 7, 1976. I enclose copy of a communication sent to the banks which indicates the principal items that will be discussed at this meeting.

The Governor wishes to utilize this occasion also to indicate certain modifications in the Reserve Bank's refinance policy. The main modifications are indicated below:

(1) The basic refinance limit allowed to each bank equal to 1 per cent of its demand and time liabilities as of last Friday of September 1975, will be allowed to continue till the end of October 1976. This basic limit which will amount to about Rs 140 crores is intended primarily to assist banks in dealing with day-to-day problems of clearing, etc.

(2) The rest of refinance facilities will continue to be on a discretionary basis. Discretionary refinance related to export performance given to the banks during the busy season of 1975-76 will also be continued till the end of October 1976. However, banks will be informed that where their export credit performance requires additional support from the Reserve Bank, we will be prepared to reconsider on merits further refinance facilities in this category. Such refinance related to export performance will continue to be available at a rate of interest of 11.5 per cent.

(3) All other discretionary refinance limits which are due to expire at the end of April 1976 will be allowed to expire as of that date. However, banks can apply for special discretionary refinance limits which will be considered on merits and appropriate accommodation will be extended.

(4) With regard to refinance for public food procurement operations, the present formula is as follows:

- (a) For the first Rs 450 crores, no refinance.
- (b) Between Rs 450 and 600 crores, refinance at 50 per cent.
- (c) Above Rs 600 crores, refinance at 100 per cent.

This formula was introduced last year when the total requirements for food procurement operations were estimated at Rs 1,100 to Rs 1,200 crores. Since then, the demand on the banking system for food procurement credit has vastly increased and stands presently over Rs 1,580 crores. For the next few months, FCI has sought additional accommodation and so have the State Governments and State Government agencies engaged in the procurement of Rabi crops. Altogether, it is expected that the peak requirement of food refinance during July-August 1976 will

be around Rs 2,050 crores. In view of this, it is proposed to adopt the following refinance formula in respect of food procurement for the slack season, 1.5.1976 to 31.10.1976:

- (a) The level of banks' commitment of resources will be increased from Rs 523 crores in the old formula to Rs 800 crores. In other words, on the first Rs 800 crores, no refinance will be provided.
- (b) On all additional food procurement credit, that is, over and above Rs 800 crores, refinance at the rate of two-thirds of the incremental credit will be provided. On this basis, the proposed refinance formula will mean, at the peak food credit of Rs 2,050 crores expected in July–August 1976, RBI's refinance commitment of Rs 833 crores and banks commitment of resources at Rs 1,217 crores. The immediate impact on the banks is expected to be of the order of Rs 70 crores as may be seen from the table below:

Food Credit as on 23rd April 1976

i. Total Food Credit	Rs	1586 crores
ii. Refinance entitlement as per current formula	Rs	1061 crores
iii. Actual availment by banks	Rs	592 crores
iv. Refinance entitlement as per proposed formula	Rs	524 crores
v. Repayment required iii–iv	Rs	68 crores

To take care of undue difficulties in individual cases arising from this change, RBI will provide *ad hoc* accommodation on merits of each case for a temporary period, say, up to end of June, and review the position later.

(5) As regards bill rediscount accommodation, the following limits have been sanctioned to scheduled commercial banks for the current busy season:

(a) basic rediscount limit (at bank rate of 9 per cent)	Rs	150 crores
(b) additional limits (at varying rates)	Rs	141 crores
Total	Rs	291 crores

The basic limits will be extended till October 31, 1976 and the additional bill rediscount limits till the end of June 1976 when the position will be reviewed.

(As may be observed, the principal change that will be made is with regard to food refinance entitlements. In view of the substantial deposit resources with the banks as well as of availability of funds in the call money market, it is not anticipated that banks will have serious problems. In case any individual bank is in difficulties, we shall, of course, provide assistance on an *ad hoc* basis.)

(6) Apart from the above, Governor desires to announce the following pattern of interest rates in regard to refinance:

- (a) On the basic refinance limit equal to 1 per cent of demand and time liabilities, the rate of interest will be 10 per cent per annum, as at present.
- (b) On refinance for food procurement, the rate of interest will be 10 per cent, as at present.
- (c) On discretionary refinance related to export performance, the rate of interest will be 11½ per cent per annum, as at present.
- (d) On other discretionary refinance, the Reserve Bank retains the option to vary

the rates of interest depending on the magnitude and purposes of such refinance. However, the maximum rate of interest that may be levied on such discretionary refinance will not be more than the maximum ceiling rate of interest which the banks are allowed to charge in terms of the Governor's letter to the banks dated March 12, 1976. This means that compared to the present maximum rate of interest of 18 per cent leviable by the Reserve Bank on discretionary refinance, the proposed maximum rate will be corresponding to the ceiling rate of 16.5 per cent less the tax on interest income in the case of large banks; 17.5 per cent less the tax on interest income for banks with deposits between Rs 25 crores and Rs 50 crores. In the case of banks with deposits of less than Rs 25 crores, since no ceiling rate has been imposed, there is no corresponding maximum of interest on RBI refinance. However, it is not intended to charge these small banks more than for other banks. Hence, the effective maximum rate of interest on discretionary refinance would be reduced from the 10 per cent to somewhat lower rates.

I believe Government will have no objection to these changes. In case the Government wish to discuss this with the Governor of RBI, he will be in Delhi in the early part of next week and Economic Secretary or you may wish to contact him.

With kind regards,

Dr Manmohan Singh
Chief Economic Advisor, Ministry of Finance
Department of Economic Affairs
Government of India, New Delhi

Yours sincerely,
K.S. KRISHNASWAMY

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THE PRESENT MONETARY SITUATION

I find the present monetary and price situation quite disturbing. Money supply over the year is 12 per cent higher as against 7 per cent in the previous year; on a fiscal year basis, the comparable figures are approximately 7 per cent and 4 per cent respectively. Though wholesale prices have declined slightly during the second half of July, the index is still about 1 per cent higher over the year and about 8 per cent higher than in March 1976.

The striking features of the present situation are as follows:

1. There is a large inflow of funds from abroad which, given the inadequacy of investment, both public and private, is increasing the foreign exchange assets of the banking sector and, therefore, adding to money supply. This inflow is likely to continue for some time, say, at least a year or two, because our exports are picking up, imports of food and fertilizer are expected to decline without an offsetting increase in other imports, the rupee is less weak and more stable than many other currencies and remittances through official channels are booming. It will take some time for these foreign exchange assets to get absorbed in a general increase in the level of investment.

2. There has been a substantial turnaround in the Government's budgetary position. The Government's deficit, howsoever measured, is substantially lower than it was last year. It is a fairly safe guess that the substantially smaller deficit indicates not merely larger receipts and some effort to keep down administrative expenditure, but also continuance of a low level of investment. It is possible that the investment expenditure will be stepped up after October or so, in order to fulfil the indications in the annual plan and the budget. Since the need for increase in public investment is imperative, it can be expected that in the rest of the fiscal year the budget would not be as much of a restraining factor in the monetary situation as it has been so far.

3. Bank credit has expanded by a very large magnitude as well as proportion. The bulk of this expansion has, no doubt, been on account of food, fertilizer, export and other high priority purposes. The pattern of credit expansion is now directed, scrutinized and monitored by the Reserve Bank more frequently and effectively than before, but the overwhelming fact is that the total volume of bank credit for all purposes taken together is largely responsible for the disproportionate expansion of money supply. There is a possibility—as has happened in some years immediately preceding—of a spurt in bank credit during the months of September and October. If this possibility fructifies (may be due to larger drawals for fertilizer, oil, export, etc.), the expansion of money supply will get a further boost, just on the eve of increase in budgetary outlay.

4. There is a definite change of price expectations in the market. The prices of the main cereals may be kept down by larger releases from public stocks, and the prices of cotton and edible oils may be restrained by the impact of recent official pronouncements, but the range of essential goods in the cost of living index is so wide that it appears doubtful whether prices can be kept stable or properly restrained by action aimed at individual commodities. It is very difficult, for instance, to control the prices of pulses, potatoes, onions, vegetables, meat, marine products, and while the prices of cloth, edible oil, soap, etc. are amenable to control, ensuring their availability at these prices is not always feasible.

The table annexed compares the movement of monetary indicators between March 26, and July 30, 1976 with the RBI projections made in March 1976 when, among other things, it was agreed with Government that an expansion of 12 per cent in money supply (M-1) could be considered as the safe outer limit for fiscal 1976-77. One of the welcome but upsetting changes since then is that the foreign exchange assets have risen significantly instead of staying constant; this change alone would, at the present level, be roughly 2 per cent more to the monetary expansion and since this welcome factor is likely to remain buoyant, the change over the year, as a whole, would be substantially larger. Some of the other comparisons would need some minor amendment to allow for changes between 26 March and 31 March as well as the inevitable changes that come about with the passage of time after estimates are made, but it is clear that a fairly large part of the monetary expansion postulated for the year has already taken place while the 'normal' season for expansion in budgetary expenditure and bank credit still lies ahead. Besides, a fairly large part of the monetary expansion over the year as well as fiscal year has been

under currency which portends a large potential expansion of money supply as a whole.

In order to curb the expansionary trend and influence of the banking portion of money supply, I suggest that the following measures be taken:

- (a) With effect from Friday, September 3, the proportion of aggregate demand and time liabilities required to be kept by scheduled commercial banks with RBI should be raised from 4 per cent to 5 per cent. Simultaneously, banks should be required to progressively reduce their drawal of refinance from RBI (whether on food or other accounts) in a phased manner by end-October to a reasonable level, significantly lower than their present drawals. Banks should also be advised to be more careful in their supervision over export credit and accommodation granted for textiles, edible oils, steel and metals.
- (b) After some time, say, in October or latest November, Bank Rate should be raised from 9 per cent to 10 per cent and the ceilings which were imposed or advised in recent months on lending rates, inter-bank rates, etc., should be either lifted completely or suitably revised upwards. Only export credit rates may remain unchanged together with term-lending rates.
- (c) All demands made for reduction in rates of interest on loans or deposits must be firmly rejected.

Bombay
August 15, 1976

R.K. HAZARI
Deputy Governor

Table: Monetary Indicators

	1976-77	
	RBI Projection in March 1976	Actual: 26 March till 30 July
	(Rs Crores)	
1. Money Supply (M-1)	1550	845
	(+12.0)	(+6.7)
a. Currency	600	386
b. Demand Deposits	950	467
2. Money Supply plus Time Deposits (M-2)	3200	1830
	(+15.2)	(+8.6)
3. Factors affecting money supply:		
a. Net bank credit to Government	1300	605
i) RBI net credit to Government	800	244
ii) Other banks' net credit to Government	500	361
b. Bank credit to commercial sector	2280	911
	(+17.1)	(+6.8)
i. RBI credit	100	79
ii. Other banks' credit	2180*	832
c. Net foreign exchange assets of banking sector	Nil	356
d. Net monetary liabilities of banking sector of which	2050	1018
i) Time Deposits	1750	985

* Including Rs 250 crores each, that is Rs 500 crores for food and fertilizer.

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No. 6(1) Ec.Dn./77

GOVERNMENT OF INDIA
 MINISTRY OF FINANCE
 DEPARTMENT OF ECONOMIC AFFAIRS
 NEW DELHI
 27th January, 1977

I am directed to circulate herewith the minute of the meeting held on 20 January 1977 under the Chairmanship of Finance Minister to discuss the monetary and credit situation.

M.L. KAPUR
 Asstt. Eco. Advisor

*Ministry of Finance**Reserve Bank of India*

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| 1. Shri Pranab Mukherjee
Minister for Revenue and Banking | 1. Shri K.R. Puri
Governor
Reserve Bank of India |
| 2. Shri H.N. Ray
Finance Secretary | 2. Dr K.S. Krishnaswamy
Deputy Governor, Reserve Bank of India |
| 3. Dr Manmohan Singh
Secretary (Economic Affairs) | 3. Shri J.C. Luther,
Deputy Governor, Reserve Bank of India |
| 4. Shri G. Ramachandran
Secretary (Expenditure) | |
| 5. Shri M. Narasimhan
Secretary (Banking) | |
| 6. Dr R.M. Honavar
Economic Advisor | |
| 7. PS to FM | |

Minutes of the meeting held on 20.1.1977 under Finance Minister's
 Chairmanship to discuss the monetary and credit situation.

Present

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| Shri Pranab Mukherjee
Minister for Revenue and Banking | Shri K.R. Puri
Governor, Reserve Bank of India |
| Shri H.N. Ray
Finance Secretary | Dr K.S. Krishnaswamy
Deputy Governor, Reserve Bank of India |
| Dr Manmohan Singh
Secretary (Economic Affairs) | Shri J.C. Luther
Deputy Governor, Reserve Bank of India |

Shri G. Ramachandran
Secretary (Expenditure)

Shri M. Narasimhan
Secretary (Banking)

Dr R.M. Honavar
Economic Advisor

The meeting commenced with the Governor, Reserve Bank of India, explaining the factors responsible for the rather steep increase in money supply in the current fiscal year. He stressed that the main factors responsible were food credit and the sharp increase in foreign exchange assets, and also mentioned that there has been a sharp rise in non-food credit as well. He pointed out that a large proportion of this expansion in non-food credit went to priority sectors and exports. Among the priority sectors he mentioned industries like coal, steel, cement and cotton textiles, but added that there was hardly increase in the credit extended to the textile industry in spite of an increase in production. He pointed out that public sector projects were also receiving large amounts of credit. Banks were experiencing a great deal of difficulty in restricting credit because of two factors. Firstly, in a number of industries, although production has not been increasing as rapidly as in the early part of the current financial year, large inventories have been accumulated because of lack of demand for coal, steel and cement as instances in point. If the banks were to deny credit to these industries to carry these inventories, there would be large scale closures and a consequential decline in output and employment. Secondly, he pointed out that an increase in prices of a large number of industrial raw materials led to a sharp rise in the value of inventories, and this again made it difficult for the banks to restrict credit for fear of affecting production adversely.

2. He stressed that the Reserve Bank was aware of the consequences of such an expansion of money supply and had now begun to monitor closely bank lending to industry, particularly for maintenance of inventories of raw materials and finished products. The Bank was now getting much more information on the details of bank lending than before and was therefore in a much better position to regulate credit to different sectors. He maintained that in a situation in which maintaining output and employment were important considerations and there were other policy objectives to be promoted, banks had to be circumspect in utilizing the curtailment of credit as a policy instrument. He, therefore, felt that the attack on the problem of an increase in money supply should come from two other directions, namely, a reduction in food stocks and a reduction in foreign exchange assets.

3. There was discussion on the current situation and the factors responsible for the sharp increase in money supply. It was agreed that an increase in money supply of the order of 16 per cent during the current year coming on top of an increase of 11.7 per cent in 1975-76 implies a serious inflationary threat. Therefore, the prime objective of policy should be to limit the growth of money supply.

4. There was a difference of opinion as to the amount of regulation that should be exercised with regard to non-food credit. On the one hand, it was argued that

since the peak of the busy season is approaching, controlling the expansion of non-food credit would impose serious hardship on industries like sugar, jute and cotton textiles. Restriction of credit may mean that not only would there be many closures in cotton textile and jute industries, but cane growers would not receive payment for their supplies to sugar mills. Therefore, any regulation of non-food credit, particularly of the type which has been imposed recently by the Reserve Bank, would have to be moderated so far as these industries were concerned. In any case, there was no scope for a further tightening of non-food credit. Credit policy should be tightened in other directions, viz., reduction in production of coal and steel so that stocks go down, reduction in receivables by public sector enterprises, reduction in food credit, etc.

5. On the other hand, it was argued that if credit policy is to accommodate factors like increases in stocks and increases in prices, the whole purposes of monetary regulation would be defeated. It would only mean an acquiescence in the speculative activities of certain interests in the name of employment. Since the objective of a restrictive monetary policy was to compel industry to reorganize its ways of working in such a way that the demand for credit would be reduced, the proposal to make available credit as and when needed by these industries would render monetary policy ineffective as an instrument of economic policy. Therefore, the recent steps taken by the Reserve Bank to impound a proportion of the accrual of deposits since the beginning of January were welcome. It was stated that taking into account the likely growth in deposits in the remaining months of the year, there would be adequate resources with the banking system, even after complying with the new directives to meet the requirements of the busy season, and of seasonal industries like sugar provided suitable action was taken on other fronts. The Reserve Bank's view was that the present policy could accommodate the genuine needs of seasonal industries like sugar.

6. A point was raised about the failure of the Banks to comply with the RBI's directives regarding the higher statutory cash reserves and the statutory liquidity ratio. It was pointed out that compliance takes time, and that sudden action by banks would lead to a serious disruption in their working. There was, however, no question of a willful defiance on the part of banks.

7. It was also agreed that food procurement was a datum as it was a basic instrument of Government policy. But the inflationary consequences of such a policy in the present context needed to be pointed out and even though suggestions in the past to reduce food stocks by 2 to 3 million tonnes by sale to trade to mop up a sizeable volume of money supply have not been accepted, an attempt should be made once again to persuade Government that such an action was absolutely necessary if the country is not to be subject to serious inflationary pressures in the coming year. It was also agreed that an attempt should be made to draw down foreign exchange reserves so that the expansionary impact of the growth of reserves would be moderated. However, in any monetary planning, it had to be recognized that drawing down of reserves was bound to be a slow process.

8. The Finance Minister summed up the discussion by stating that in the interest of price stability, there was no alternative to a restrictive monetary policy. He also

stated that there was no question of relaxing the recent measures adopted by the RBI for further control of non-food credit. The genuine needs of seasonal industries and priority sectors had to be met by redeployment of credit and not by relaxation of overall monetary discipline.

9. It was also pointed out that whatever may be the theory of monetary control, in practice, the Reserve Bank and the Commercial Banks were subjected to continuous pressure to relax their restrictive policy by various authorities such as the Central Ministries and the State Governments. It was agreed that the Reserve Bank should not yield to such pressures. It was agreed that the objective of policy should not definitely be to finance stocks, irrespective of larger economic considerations merely because this would lead to difficulties so far as the individual units were concerned. Therefore, Reserve Bank should monitor much more carefully the current utilization of bank credit. In any case, a much more restrictive type of credit planning will have to be done for 1977-78 in view of the additions to money supply that have already taken place in 1975-76 and 1976-77. For this purpose, it was agreed that representatives of the Department of Economic Affairs and the Department of Banking should have detailed discussions with the Reserve Bank before a credit plan for next year is finally drawn up.

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CREDIT PLANNING CELL

March 3, 1977

Main issues discussed at a meeting presided over by the
Cabinet Secretary on February 9, 1977

1. The Cabinet Secretary Shri B.D. Pande pointed out that the Government had taken all necessary measures to keep inflation in check, assist production and use foreign exchange through liberalization of imports. He also referred to several harsh measures taken by the Government such as impounding of wages and salaries. There is almost nothing now left for the Government to do. He also mentioned that the Government budgetary deficit may be considerably less than last year and mentioned that the budgetary position may even show a surplus.

2. With regard to price trends, the Cabinet Secretary said that the wholesale index consisted of hundreds of items all of which are not amenable to Government controls. At the macro level, such widespread price increases result from large monetary expansion.

3. The Cabinet Secretary asserted that while the Government's policies were directed towards the objectives outlined above, the fly in the meeting was monetary policy which did not seem to be consistent with the general economic policies of the Government. Therefore, unless something definite was done now, we would not be able to restrict further monetary expansion during 1977-78 and there may be a rise of another 15 to 16 per cent. Considering that agricultural production will be lower and that it may not be possible to repeat the same growth rate in industrial production as that occurred in 1976-76, national income may not show any substantial rise. We must, therefore, have a consistent policy so that money supply

does not go up by more than 7 to 8 per cent. He enquired from the Reserve Bank as to what ought to be done to restrain monetary expansion, both from the Reserve Bank side as well as from the Government side. He again emphasized that something positive has to be worked out immediately as otherwise we will be in 'real trouble'.

4. Shri J.C. Luther, Deputy Governor, Reserve Bank, explained in detail the current monetary and credit situation with particular reference to its relevance to the price behaviour. He brought out that the monetary expansion has taken place on account of three major factors: (i) expansion in food credit to assist building up of buffer stocks, (ii) expansion in credit to the priority sectors, and (iii) a sizeable growth of foreign assets. He also gave figures of the sectoral deployment of non-food credit during the current financial year, and also drew attention to the general stability of prices since September. He made the point that the bulk of price increases occurred between April and June 1976 and allowing for the increase in prices of a few commodities like cotton and oilseeds, the increase in wholesale prices is not as large as it is made out.

5. Shri Luther mentioned that the Reserve Bank would, as is always the practice, take an integrated view of the factors responsible for monetary expansion and their relevance to the increase in commodity prices. He also said that preliminary thinking on the parameters relevant for monetary expansion in 1977-78 has already taken place in the Reserve Bank. There has also been a preliminary meeting between the Reserve Bank and the Department of Economic Affairs and the Department of Banking on these aspects. These exercises will be renewed after the end of March when some up-to-date information would become available.

6. Dr Manmohan Singh also emphasized the difficult price situation and felt that the effects of such large monetary expansion which is taking place currently will be felt on the price situation after a time lag and would create macro imbalances. This would happen despite all administrative measures. He, therefore, felt that the present rates of growth in money supply calls for serious concern. He was, however, of the view that the Reserve Bank effort to restrict credit without hurting production should be supported. Dr Manmohan Singh, however, raised the point as to how we could reconcile the objective of containing money supply with the directive given by the Department of Banking regarding the minimum share of priority sector advances at 33.1/3 per cent by March 1979.

7. Shri Luther, in response to a query raised by Shri H.N. Ray, Finance Secretary about the increases in credit in the light of the variations in industrial production, mentioned that there has been no flow of credit inconsistent with the overall policy. (Shri Roy had mentioned that the index number of industrial production in September was lower than in the peak reached in March 1976.) Shri Luther also mentioned, again with reference to Shri H.N. Ray's comment, that banks are being allowed to comply with the increased cash reserve requirements in a phased manner so as to not create any immediate dislocations in credit arrangements.

8. Shri M. Narasimhan, Secretary, Banking said that he would not subscribe to any view suggesting going back on the target of reaching 33.1/3 per cent of bank credit in favour of priority sectors by March 1979, because this was a commitment given by the Minister for Revenue and Banking to the Parliament. Shri Narasimhan

mentioned that there should be no difficulty for the banking system to comply with this target if only the excess credit which is already in the pipeline (on the basis of the application of Tandon Committee norms) could be redeployed by banks. The Cabinet Secretary also endorsed Shri Narasimhan's point relating to the target of 33.1/3 per cent and the scope for redeployment of credit.

9. The Cabinet Secretary, while concluding the deliberations, mentioned the following additional points:

- (a) For 1977-78, the level of food procurement credit need not go above the level of Rs 2,300 crores. He felt that the level may even come down because there may not be imports and production will also be lower.
- (b) It will be unrealistic to assume that there will be no substantial increase in foreign exchange reserves. The import programme for next year has already been cleared but still there would be a substantial surplus in balance of payments and the foreign exchange reserves may again rise by another Rs, 1000 crores or so. (On this point, when Shri Luther said that the Government had indicated a definite programme for the deployment of foreign exchange reserves, Shri Pande felt that the Reserve Bank should have an independent view of its own.)
- (c) Through larger efforts for deposit mobilization, particularly time deposits, it may be possible to create more substantial contractionary influences on money supply, particularly in respect of deposits arising from the inflow of foreign exchange.
- (d) Reserve Bank should evolve a more positive programme indicating the specific steps that will be taken to restrain monetary expansion during 1977-78.

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D.O. No. CPC.76/C. 279-77
A. Raman
Advisor

July 6, 1977

Dear Shri Row,

This is with reference to your telephonic conversation with the Governor. As desired by the Governor, I enclose a note giving material for the preparation of a reply to Prof. C.N. Vakil. This has been approved by the Governor.

With kind regards,

Yours sincerely,
A. RAMAN

Shri K.N. Row
Joint Secretary, Department of Economic Affairs
Ministry of Finance
Government of India
New Delhi

Encl:

1. The memorandum voices the apprehension that the process of reduction in interest rates which, though initially selective, may soon get generalized. It is also felt that under the existing situation, the reduction in interest rates will help only to strengthen the forces of commodity speculation.

The accent of credit policy continues to be one of restraint. Apart from the lag effects of the increase in money supply recorded last year, expansionary impulses on money supply continue to emanate from further increases in foreign exchange reserves and larger requirements of the Food Corporation of India to finance food procurement as well as fertilizer transactions. At the same time, current expectations are that the growth in national output may not be much higher than in 1976-77. In this situation, the need to continue the present policy of monetary restraint remains as strong as heretofore.

The Reserve Bank has formulated its credit policy which was announced on May 27, 1977 bearing in mind the emphasis of policy mentioned above. The policy aims at restraining overall monetary expansion, and in fact the area of automatic refinance facilities has been curtailed. While credit thus remains generally tight, the Reserve Bank has attempted some rationalization of the interest rate structure. This has involved some lowering of the rates for certain sectors.

An area where the interest rates have been lowered relates to term loans beyond three years for capital investment which incidentally forms a small proportion of bank credit. The reasons for this are quite obvious. The cost of investment capital is high and this has been one of the factors making for a high-cost economy. The attempt, therefore, was to streamline the rates of interest charged by commercial banks on term lending so as to bring them on par with the rates of interest charged by term-lending institutions.

As there is no general reduction in interest rates, there need be no apprehension that the lowering of interest rates would lead to commodity speculation. It may also be noted that the selective credit controls have not only been retained but have been tightened in appropriate cases, for example, the margin requirements have been tightened in some areas, particularly oilseeds. The enhanced margins which banks were required to observe prior to February 16, 1977 were also restored. Banks are now more attuned to lending on the basis of inventory norms so that credit discipline is maintained.

2. The memorandum has pointed out that under conditions of past and expected inflation, the powerful instruments of credit policy are general weapons like quantitative restrictions on credit and steep hikes in interest rates; both short- and long-term rates should tend to go up.

In the credit policy that has been currently designed, the lendable resources of banks have been further regulated. In terms of the current cash and liquidity requirements, 49 per cent of incremental deposits would be required to be kept as cash or liquid assets. In other words, only about one-half of the deposit accretion is available for lending to both the public and private sectors including food procurement operations. In addition, the assistance from the Reserve Bank in the form of refinance and rediscount has also been severely restricted. This will be borne out from the fact that borrowings from the Reserve Bank of India came down from

Rs 967 crores at the end of March 1977 to Rs 563 crores by the end of June 1977 (a decline of Rs 404 crores). Similarly, bill rediscount assistance has also come down from Rs 184 crores to Rs 116 crores. Thus, the objective is to keep the supply of money under severe check and it is possible to control credit expansion without a further increase in interest rates which are already high and which can only have counterproductive effects. While the policy has been directed towards restraining monetary expansion, it has, at the same time, been oriented towards promoting investment, assisting production and exports and augmenting supplies of essential consumer goods and industrial raw materials through imports. There is thus a greater degree of selectivity in the deployment of credit.

3. The memorandum has taken exception to the bifurcation of savings accounts and has pleaded that we should immediately return to the status quo ante in regard to the interest rate policy which prevailed before the changes came about in May 1977. The memorandum points out that the argument that the reduction in short-term deposit rates was necessary to increase the incentive on long-term deposits, is perverse. The memorandum raises the question whether this objective should not have been achieved by raising both the rates, long-term deposits slightly more than that of short-term deposits.

The main reason why the bifurcation of savings accounts was brought about was that the chequeable savings deposits were operated more or less as current accounts, and there was no reason why such current accounts should be paid interest at 5 per cent. Even here, the Reserve Bank has permitted this class of depositors to earn 3 per cent. At the same time, the rate of 5 per cent is protected for the genuine savers. The bifurcation has thus sought to correct the distortions which have, all along, prevailed in the savings deposits system. Similarly, opportunity has also been taken to widen the spread between extreme short-term deposit rates and long-term deposit rates. The rationale behind this streamlining is that the savings character of term deposits should be rewarded more than the short-term placement of funds character of such deposits.

4. The memorandum has also posed the following points: the authorities at one stage wanted to increase the influx of outside funds by liberalizing terms of lending to financial institutions; at the same time, they are expecting holders of financial resources to contribute more to owned funds. The memorandum feels there is a severe contradiction here. One does not see such a contradiction. The basic rationale behind the changes in the deposit rates is also to make possible greater interest in equity by holders of financial resources.

To sum up, the readjustment in term loan rates and a streamlining of deposit rates would, by no means, constitute a change in the emphasis of the current monetary policy which continues to recognize the need for maximum possible restraint. For this purpose, the necessary monetary weapons have been employed and it is the determination of the Reserve Bank to employ them to the fullest extent possible to ensure that the overall credit expansion is well within what is warranted by the requirements of the economy consistent with the need of monetary stability. There is thus nothing in the credit policy which could give rise to changes in price expectations.

D.O.No. CPC 96/C.279/79

July 16, 1979

My dear Manmohan,

I refer to your letter D.O.No. 1337-SSEA/79 of July 3, 1979 as also Malhotra's letter No. 548-S/AS(EF)-79 of June 5, 1979. The attached note prepared in the Credit Planning Cell details the steps that have been taken by RBI in the past few months to restrain the expansion of credit. These measures relate both to aggregate credit expansion as well as credit for trade in specific commodities. The impact of these measures on bank credit to the non-preferred sectors is evident in Table 1 on page 8-A of the attached note.

Despite these restrictive measures, the increase in money supply during this financial year has been about the same as in the corresponding period of last year. The principal expansionary forces appear to be credit to Government and credit for food procurement (see table below). Further, almost the entire expansion in money supply during this financial year has taken the form of currency, which makes it even more a matter of concern.

	(Rs. Crores)	
	Increase from 30.3.79 to 22.6.79	Increase from 31.3.78 to 23.6.78
Money Supply	968	971
Net Bank Credit to Government	1406	434
Food Procurement Credit	688	520

For curbing credit expansion, we have already immobilized 50 per cent of deposits of banks and abridged their access to other sources. As food credit comes down in the next few months, we could perhaps cut back further on our refinance for food procurement. But this can only be marginal. I do not think we should tamper, at this stage, with the refinance facilities we have given in respect of export and credit to small farmers. My assessment of the current situation is that further intensification of quantitative restraint on banks is undesirable and probably infeasible. Likewise, while we would continue to press for reduction in the relative share of large and medium industry and trade in bank credit, it would be unrealistic to expect a large change in a matter of months. Draconian measures to restrain credit further will inevitably have to be applied across the board; and at least in particular areas, this could well result in disruption of productive activities and creation of shortages. We must clearly recognize the administrative limitations, both in RBI and in the banks that make it impossible to fine-tune the allocation of credit to the extent that we would like.

Bearing this in mind, I suggest that there are basically two courses of action available to us. Both are unpalatable, but they are not mutually exclusive.

- (i) The restraint on credit must be allowed to affect, if necessary, even the preferred sectors, that is, priority sectors and sick units. In a situation where the norms for entitlement to bank credit are being generally tightened and delegation down

the line is being restricted, it would no longer be easy to shield the preferred sectors from the scarcity of credit. The problem of overdues in these sectors will also have to be dealt with severely.

- (ii) The cost of credit to the borrowers must be raised. This is clearly necessary to induce borrowers to use credit more efficiently and maintain production and trade activities with less recourse to bank borrowing. Especially as expectations of further inflation gain strength, the present levels of lending rates would not be compatible with the need for further monetary restraint. The increase in the cost of credit may be brought about in either of the following two ways:
- (a) raising ceilings on interest rates; or
 - (b) making only a part (rather than the whole) of interest cost a deductible expense in computing income-tax liability.

In the light of the current concern regarding the inflationary pressures in the economy, I would suggest that serious consideration be given to both the courses of action. I shall be glad to discuss these matters with you whenever you like.

With warm regards,

Yours sincerely,

Dr Manmohan Singh
Secretary
Government of India
Ministry of Finance
Department of Economic Affairs
New Delhi

I.G. PATEL

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CREDIT PLANNING CELL REVIEW OF RECENT BANKING TRENDS

Placed below is a note reviewing the recent banking trends. The note also examines some of the implications for credit policy. The note has been prepared as a background for discussions.

S.S. TARAPORE
3.9.1981

Ad(M)

Personally, my view is that we would be in a better position to evaluate the banking situation in mid-October 1981. First, there has been a distinct declaration in the growth of deposits during the six weeks since July 10, 1981. Secondly, the bulk of the excess liquidity seems to be concentrated in the SBI. Of the total excess liquidity of Rs 698 crores for the banking system, SBI accounts for Rs 538 crores (Table 4). Furthermore, the impact of the July 1981 measures would also begin to be reflected in a declaration in the pace of deposit growth during the second half of 1981-82. I would, therefore, not agree, at this stage, with the suggestion made in the note that

CRR be raised further by 1 percentage point. However, we could review the situation in mid-October.

2. I would go along with the suggestion made in the note that the second phase of the SLR be prepared by three weeks. However, to synchronize with this, the Central Government borrowing a programme scheduled for 2nd/3rd week of October may also be brought forward to the first week of October.

N.A. MAJUMDAR
4.9.1981

CREDIT PLANNING CELL

Review of Recent Banking Trends: Some Implications for Credit Policy

In May 1981, certain monetary measures were introduced and these were further reinforced substantially in July 1981. This note reviews the trends in banking up to 21 August 1981, and an estimate is attempted of the sources and uses of funds of the banking system during the second half of 1981–82. Finally, some credit policy issues are raised as a background for discussions.

I. Trends in the First Half of 1981–82

2. There has been a strong uptrend in aggregate deposits in the current financial year with a growth of Rs 2,937 crores (+7.8 per cent) up to August 21, 1981, the comparable increase in 1980–81 was Rs 2,078 crores (+6.6 per cent). There has been a marked decline in the weekly average rate of growth from about Rs 170 crores in the first fifteen weeks up to July 10, 1981 to Rs 63 crores per week in the subsequent six weeks (Table 1). For the first half of 1981–82, it is estimated that the increase in aggregate deposits would be around Rs 3,500 crores (9.2 per cent) as compared with an increase of Rs 2,725 crores (8.6 per cent) in the first half of 1981–81. If the increase in aggregate deposits in the full financial year 1981–82 were only Rs 6,600 crores (17.4 per cent) as projected earlier, the share of the first half in the total for the year would be 53 per cent, which would be quite contrary to the normal trend that the share of the first half is less than that in the second half.

3. The trend in non-food credit is somewhat disturbing as the increase in the current financial year up to August 21, 1981 was Rs 1,260 crores (5.4 per cent) as compared with an increase of only Rs 433 crores (2.2. per cent) in the comparable period of 1980–81. In the first fifteen weeks of the current financial year up to July 10, the average weekly increase in non-food credit was Rs 59 crores, while in the subsequent six weeks the average increase was Rs 64 crores; the increase is large in the week of July 17, but even if this is excluded the pace of increase is still high (Table 2). The pace of increase in non-food credit is of concern, especially as there has been a decline in credit to the petroleum companies in the current financial year up to August 21, 1981 of Rs 84 crores. It is estimated that the increase in non-food credit in the first half of 1981–82 would amount to Rs 1,600 crores (6.8 per cent) as compared with a comparable increase of only Rs 774 crores (4 per cent) in the first half of 1980–81. If the non-food credit in the full financial year 1981–82 is to be contained within the guideline set out in May 1981, the share of the first half

would amount to 39 per cent if the total for 1981–82 were within the guideline (Table 3); this is historically an unusually high rate for the first half and it would therefore appear that the guideline for the full financial year is unlikely to be adhered to.

4. The liquidity of the banking system was 35.6 per cent as on August 21, 1981 and the excess liquidity, based on a 34 per cent SLR, was a little under Rs 700 crores excluding excess balances with the Reserve Bank; on a rough calculation, these excess cash balances appear to be close to Rs 350 crores. Thus, the banking system, as a whole, would be able to meet the increase in the SLR, in two phases at the end of September and the end of October 1981 from its own resources. The excess liquidity is, however, not evenly distributed among the major banks. As on 21 August 1981, the SBI's liquidity was 39.2 per cent while that of all the other banks was 34.5 per cent (Table 4). However, if excess cash balances are taken into account, most of the banks would be able to meet the enhanced SLR requirement without any difficulty. (A few banks like UCO and Punjab and Sind appear to be in a liquidity bind.)

II. Estimates for the Full Financial Year 1981–82

5. An attempt has been made to prepare revised estimates of the sources and uses of funds for the full financial year 1981–82 with a break up into the two half years. The major changes from the earlier projections are outlined below:

- (a) *Deposits*: It is assumed that the increase in deposits in the second half will be at least equal to the increase in the first half, and on this basis the estimate for the full financial year 1981–82 is put at Rs 7,000 crores (18.5 per cent) as compared with Rs 6,600 crores (17.4 per cent) estimated earlier. The estimate of Rs 7,000 crores is in line with the estimate of deposit growth reflected in the scaled down estimates obtained from the credit budgets. The banking system already has sufficient liquidity to meet the enhanced SLR requirement and as such the growth of deposits in the second half is not expected to be significantly inhibited by the need for liquidity provisions.
- (b) *Non-Food Credit*: On the basis of the revised deposit estimates and adjusting for reserve requirements and food credit, it is estimated that the expansion of non-food credit in 1981–82 would amount to Rs 4,400 crores; this is based on a modest increase of Rs 2,800 crores in the second half of 1981–82 as compared with an increase of Rs Rs 3,300 crores in the second half of 1980–81. However, it should be noted that in the second half of 1980–81, there was an increase in petroleum credit of about Rs 250 crores while in the second half of 1981–82, a decline of about Rs 150 crores is forecast for petroleum credit. In the second half of 1981–82, there are likely to be additional requirements, over and above the provisions made in our earlier demand derived estimates, to the tune of about Rs 200 crores for fertilizers and about Rs 250 crores for edible oils; the increase in credit demand for sugar is not expected to be felt in 1981–82. In the case of increased imports by public distribution agencies, the SBI has already agreed in the credit budget discussions that these credit requirements would be provided for by the SBI within its non-food credit expansion. Hence, at this stage, it would not appear

necessary to alter the basic guideline for the banking system as a whole that the non-food credit expansion in 1981–82 should be contained within the expansion in 1980–81, that is, the expansion should be marginally below Rs 4,074 crores.

III. Credit Policy Issues

6. The above brief review of banking trends points to the likely necessity for certain further measures. As already stated above, the growth of deposits and non-food credit have been showing signs of a slowdown in recent weeks and tentatively two trigger points have been suggested for the first half of 1981–82 (viz. a deposit growth of Rs 3,500 crores and non-food credit expansion of Rs 1,400 crores), and if these are exceeded by the end of September 1981 there would be a strong case for further measures.

7. To the extent that an assessment is to be made in early September 1981, there is sufficient reason to believe that these trigger points would be exceeded by the end of September 1981. The two options would be to initiate certain measures in early September 1981 or to defer these to late October 1981. The case in favour of the earlier date is that the measures would be effective before further credit expansion takes place and the banks would have more time to make the adjustments. Furthermore, even if there is any overshooting in the extent of tightening of the policy, rapid relaxation would be possible by providing RBI accommodation or in an extreme case, a part of the impounded deposits could be released.

8. The argument in favour of deferring the measures till the end of October 1981, would be that a clearer impact of the July 1981 measures would be visible and the element of conjecture would be greatly reduced.

9. On balance, the more prudent course would be to opt for early measures with a more accommodative refinance/rediscout policy to take care of problems of banks which face a liquidity bind even though they are adhering to the credit guideline set out in May 1981. The possible measures which could be considered are as follows:

- (i) *SLR*: In July 1981, it was announced that the SLR will be raised from 34 per cent to 35 per cent of total demand and time liabilities—34.5 per cent effective from 25 September 1981, and 35 per cent, effective from October 30, 1981. In view of the comfortable liquidity position of the banking system, the effective date of the second phase of the increase in the SLR could be brought forward from October 30, 1981 to October 9, 1981, that is, advanced by a period of three weeks. The effective date for the first phase of the increase from 34 per cent to 34.5 per cent could remain unaltered at September 25, 1981.
- (ii) *CRR*: With a view to keeping a tight rein over primary money creation and its direct impact on monetary expansion as well as to slow down the pace of expansion of bank credit, the CRR could be increased from 7 per cent to 8 per cent in four increases of 0.25 per cent each, phased over the four months end-October 1981 to end-January 1982. The additional cash balances maintained with the Reserve Bank as on October 31, 1980, under the 10 per cent incremental cash reserve ratio, should not be allowed to be withdrawn. The increase in the

CRR would immobilize about Rs 450 crores of the banks resources and enable an effective correction of the excessive credit expansion of recent months. The measure would help maintain a better control over the monetary expansion generated by the excessive primary money creation, and would effectively curtail credit expansion in 1981–82 to a level within the guideline set out in May 1981.

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DO.No. S.85–2861

December 26, 1969

My dear I.G.,

I believe you have got a copy of a note which Seshadri had prepared regarding public borrowing in the Fourth Plan. One element of it was an estimation of the total amount that would be raised by the Centre, the States and public bodies like electricity boards. On this, as you know, some discussions have taken place in the Planning Commission, and further studies are in progress. We shall be separately keeping you in touch with our thinking on this.

My present letter relates to certain issues of detail, if you like, which have a bearing both on the pattern of borrowing—the shares of the Centre, the States and the public bodies—and the techniques by which they are to be achieved.

Although looked at as a total figure, the public borrowing programme for this year seems to reflect a substantial improvement on past performance, there are some significant features of it which have to be highlighted. On the whole, the Centre seems to have fared worse than in the past and we are unlikely in the Reserve Bank to have sold as much of Central securities as we had to subscribe to. The States, no doubt, have fared better than before but the improvement is more qualitative than quantitative. The State securities have not gone to a discount, but the total volume of their net borrowing is only marginally higher than before. The bulk of the improvement of the increase has been in the borrowings by public bodies. This shift reflects, in a sense, the higher yield consciousness of the investors in approved securities. The anxiety for better yields of the EPF and LIC is well known to you. Investment by banks also has shown a higher degree of preference for better yield particularly as with State loans not going to a discount, the compensatory attractions of Central loans is no longer as strong.

Another feature of this year's borrowing programme has been that we have been able to achieve an improvement in the borrowing programmes of the more backward States as well as of those States which were not too active in this area. The fact that the larger banks have been nationalized has undoubtedly helped in this.

The first issue which arises against the background set out above is whether some realignment of yields is called for between Central loans on the one hand, and State loans and loans by public bodies on the other with a view to ensure a somewhat better attention to Central loans in the future. I think the answer to this clearly is in the affirmative, and the real question to face is whether it should be done by a marginal improvement in Central yields or a marginal lowering of the yields of

other securities. In facing this question we are, as always, confronted with the dilemma of choosing between a course which is economically more sensible and one which, from the point of view of the Exchequer, seems more economical. My own feeling is that the arguments in favour of the economists' point of view, if I may so designate it, have gained a good deal of added strength in the recent past. The EPF is committed to certain yields on the provident fund deposits of employees. If anything, the pressure is going to be in an upward direction. Any attempt to lower yields will breed discontent and lead to demands for subscription to debentures and other safe but higher yielding investments or for an increase in the proportion that is to be put in non-Central securities. Yet another consideration is that with the nationalization of banks and with the stepping up of banks' contribution to approved securities, we cannot but take into account the importance of ensuring profitability of the banks which will, in fact, produce additional resources for the Exchequer. The time to quantify the improvement in Central securities is not yet, but do you agree with the view that this is now inescapable?

The second problem is of ensuring a pattern of distribution which would be more rational and more conducive to the objectives and priorities of planned development. In the past, the responsibility for settling the borrowing programme of individual States as well as of different institutions has rested primarily with the Reserve Bank with increasing measures of consultations with the Finance Ministry, and a larger voice for the Planning Commission in regard to the borrowings by State Governments themselves. The present practice is the result of historical evolution. At one time when borrowing depended upon a judgement of the market response to borrowings by different State Governments and agencies, the Reserve Bank could bring to bear what might be called expert judgement of a non-political nature on the subject. Increasingly with planning, the Finance Ministry and the Planning Commission have been having a say though final responsibility of settling with the State Governments still rests with the Reserve Bank. I do not regard this position to be satisfactory. In effect, this means that on the one hand we have to encourage the shy States to come forward with larger borrowing programmes, and on the other we have to have a running argument with those who are used to borrowing more or who have now woken up to the possibility of larger borrowings. Since the considerations on which we now say yes or no are predominantly related to such things as the importance of helping the more needy States or of judging the priority between different sectors of development—between housing and electrification for example—would it not be more appropriate to find an alternative method of allocation?

The thought that all borrowing may be centralized and the Centre could apportion a fare share to each State has crossed our minds. However, we all feel that this would not be the right answer. Past experience showed that the response was not so good when all borrowing was undertaken by the Centre, and even today the efforts made by individual State Government do play a part in securing additional contributions. It would, to my mind, be much more sensible that once the total figure of State borrowing was agreed between the RBI and Government, the allocation of it to different States was done by the Government rather than by us.

What about the institutions? Some are clearly in the central field like the IFC and the ARC. The requirements of these will have to be pre-empted. In regard to the rest, one could choose between decisions being taken at the Centre or a total figure being given to each State within which all public authorities under the State Government could be fitted in by the State Government itself. I personally prefer the latter course not only because such decentralization of decision-making is desirable in itself, but also because the State Governments are in a better position to take into account the needs of all the institutions under them including municipal bodies, while you or the Planning Commission may not be as well placed in this respect. I shall welcome your thoughts and comments on this.

If there is to be any attempt to evolve a pattern of sharing between the States of the estimated market borrowings in any year, the question will have to be considered whether there should be a precise formula—perhaps the same formula as is adopted for distributing Plan assistance. While a formula of this kind does relieve everyone concerned of all charges of discrimination or favouritism, there is a loss of flexibility. Only the other day when I was speaking to PM about large overdrafts of a number of States led by Rajasthan, she observed that Rajasthan has indeed very serious problems on hand because of the drought affliction which has become chronic for certain parts of the State. When I pointed out that this is a problem which the Centre has to take care of, she expressed some unhappiness at the fact that with the rigid formula of inter-State allocations, there is no manoeuvrability left to deal with special and unforeseen problems. It is, therefore, that I am posing this question so that it may not go by default. In the same breath, I must add that the kind of overdraft which Rajasthan and some other States have developed cannot be redeemed by any possible adjustments in their access to market borrowings.

Finally, there is one more connected issue to which I should refer. I have spoken earlier of the difference between the more aggressive States and those which are backward in the matter of tapping institutional finance for their purposes. If we bring the approved securities within the framework of a national discipline, we shall succeed in narrowing this gap. However, there are borrowings from banks which are over and above their subscription to approved securities. In respect of these, some States undoubtedly are much better placed than others. I do not know that we could or should immediately try to bring these under an overall discipline, but individual cases of large borrowings from the banking system may need growing attention in the future.

I shall be grateful for any comments or thoughts that you may have on what I have said above.

Dr I.G. Patel
Special Secretary
Department of Economic Affairs
Ministry of Finance
Government of India
New Delhi

Yours sincerely,
L.K. JHA

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D.O.No.5038 SEA/73

M.G. Kaul
Secretary

MINISTRY OF FINANCE
DEPTT. OF ECONOMIC AFFAIRS
NEW DELHI
November 12, 1973

My dear Jagannathan,

May I recall our correspondence about the Centre floating additional market borrowings during the current financial year? Our proposal was for an additional amount of Rs 200 crores for the Centre, but you had suggested at that time that we might consider Rs 100 crores in view of the state of the money market. I notice that deposits have been growing very significantly in the last few months and the indications are that they will continue to do so even in the ensuing busy season. I would, therefore, reiterate our earlier proposal for an additional allocation of market borrowings to the extent of Rs 200 crores; this seems quite possible even taken into account the likely demands for credit that might emerge in the busy season.

2. I would like to raise another point arising out of the Reserve Bank's earlier action in impounding reserves of the commercial banks. I notice that the effect of this impounding has been that the Reserve Bank's holding of Government of India treasury bills has increased substantially. It might be argued that as the Government deficit is an autonomous variable in the system, it does not matter from the point of view of monetary impact whether this deficit is financed by recourse to treasury bills or by raising market debt. However, in terms of presentation, the deficit as defined in the Budget could be reduced if the impounded reserves were to be invested in dated securities because market borrowings, as you are aware, are treated as a normal budgetary resource. I am, of course, aware that the monetary impact is not different but presentationally this has considerable advantage. I shall be grateful if you could kindly consider the possibility of either funding the treasury bills held by the Reserve Bank to this extent or in the alternative, requiring commercial banks to invest in dated securities by raising the statutory liquidity ratios. The impounded reserves may have to be released to the banks for this purpose.

3. This matter was discussed with FM who has asked that we should obtain your views in this regard.

With kind regards,

Shri S. Jagannathan
Governor
Reserve Bank of India
Bombay

Yours sincerely,
M.G. KAUL

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Ref.No.C.78-3181

RESERVE BANK OF INDIA
CENTRAL OFFICE
SECRETARY'S DEPARTMENT
BOMBAY NO. 400001
March 4, 1977

To
All brokers on the Bank's approved list in Bombay

Dear Sirs,

SALE AND PURCHASE OF GOVERNMENT OF INDIA SECURITIES —
SWITCH AND OTHER TRANSACTIONS

As you are aware, during the past few years, Reserve Bank has been extending facilities to banks and provident funds for improving the return on their investments by converting their holdings of low-yielding securities into higher yielding ones, subject to a certain annual limit. In allowing this facility, it was intended that while banks would be free to operate freely in the market and have dealings with other institutional investors without limit, the facility for switching over to a higher yielding loan/s would be made available by the Reserve Bank to a limited extent only during the financial year. It has, however, been observed that in respect of some of the switch contracts entered into by the brokers with the Reserve Bank, deliveries have been effected by banks other than those on whose behalf the contract was stated to have been made by the broker. In other words, some of the banks have availed themselves of the switch quota of other banks, in addition to their own, for converting their holdings, thus circumventing the ceiling imposed by the Reserve Bank on such switches. In order to check such and similar irregular practices which Bank views with disfavour, it has been decided to adopt the following procedure with immediate effect. We may add that as brokers of the central banking institution, the Bank expects highest professional standards from brokers on its approved list and the Bank would not like them to be a party directly or indirectly to any transaction which is not in keeping with the letter and spirit of the Bank's instructions:

- (i) Before contracting for a switch transaction involving amounts of Rs 25 lakhs or over, satisfactory documentary evidence should be produced regarding the order for the switch placed with the broker. The broker should also satisfy himself to the extent possible that the institution placing the order is actually holding the securities proposed to be sold.
- (ii) Deliveries of securities to the Bank should be made through S.G.L. transfer only, unless otherwise specifically agreed to by the Bank in special circumstances at the time of making the contract. In case, the concerned seller is not maintaining an S.G.L. account with our Public Debt Office, the delivery should be completed by tendering actual scripts.
- (iii) Deliveries of securities in respect of switch transactions should be effected

simultaneously as far as possible and in any case both the sides of the transaction should be completed within seven days from the date of the contract.

(iv) The Bank will not enter into any contract for sale of securities as part of switches three weeks before the half-yearly interest payment date of the concerned loan and deliveries of securities will be stopped two weeks before such due dates of interest.

2. It has also been observed that in respect of contracts entered into with us for outright purchase (that is, outright sale by the Bank) at times delivery is not taken within a period of one week. It has, therefore, been decided that in future if delivery is not taken within a period of one week, the Bank will have the option either to cancel the contract altogether or to change the rate of sale.

3. Please acknowledge receipt.

Yours sincerely,
SECRETARY

No.C.78-3182 of date.

Copy forwarded to the Manager, Reserve Bank of India, Securities Department, Bombay.

DEPUTY SECRETARY

No.C.78-3183 of date.

Copy forwarded to the Manager, Reserve Bank of India, Calcutta/Madras/New Delhi/Bangalore/Ahmedabad.

DEPUTY SECRETARY

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D.O.No. C-169-3847

May 25, 1978

My dear Hirubhai,

You will kindly recall our discussion recently on the question of mounting overdrafts of State Governments. This matter was also discussed by me with the members of the Committee of the Central Board at the meeting held on 24th May, 1978.

2. I enclose for your information a copy of the note prepared on the subject which was discussed by the Committee. As desired by the Committee, I have sent out telegrams to the Finance Ministers of the State Governments where accounts have been overdrawn with the Bank for considerable length of time, urging upon them to consider means to rectify the position, if necessary, in consultation with the Union Ministry of Finance. I enclose copies of the telegrams for your information.

3. On 24th May 1978, the total amount of overdraft of State Governments was about Rs 471 crores. Out of the eight overdraft states, in the case of three, viz., Rajasthan, Haryana and Nagaland overdraft have been outstanding for a relatively short period. However, five states, viz., Bihar, Madhya Pradesh, Punjab, Uttar

Pradesh and West Bengal have had persistent overdrafts with the Reserve Bank. I am giving the present overdraft position of these 5 states in the following table for your ready reference.

States	Amount of overdraft on 24.5.1978 (Rs crores)	Overdraft continues since	No. of days the overdraft continues
1. West Bengal	118.78	16.12.1977	125
2. Uttar Pradesh	145.32	4.4.1978	40
3. Madhya Pradesh	54.52	8.2.1978	83
4. Punjab	46.00	8.8.1977	204
5. Bihar	77.52	4.7.1977	250

4. What is disturbing is that not only overdrafts have not been cleared for a long period, but also that some states like Punjab and West Bengal which had only occasionally resorted to overdrafts in 1976–77 had persistent overdrafts in 1977–78. The overdrafts of all these states were cleared with Central Government's assistance at the end of June 1977. However, the above-mentioned five states overdrew on their accounts with the Reserve Bank almost immediately thereafter.

5. Reserve Bank informs the State Government of the overdraft position as soon as it emerges, and requests it to clear it immediately. It has, however, become a normal practice with the State Governments to advise the Bank that they have brought the position to the notice of the Government of India whose decisions were awaited on the request for grant of special ways and means assistance to clear the overdrafts.

6. While I appreciate that it may not be possible for all State Governments to clear their overdrafts immediately without special assistance from the Government of India, you are, no doubt, aware that it is not our practice in general to carry any overdraft position in our books from one fiscal year to another. Something definite has to be done, therefore, before the end of June in any case. At the same time, merely clearing the overdrafts in a routine manner by the Government of India will not prevent their re-emergence almost as soon as they are cleared. I would suggest, therefore, that discussions may be held with the State Governments concerned as soon as possible, with a view to arriving at some course of action which they would abide by and which would be consistent with the observance of financial prudence by all concerned. Otherwise, there is every danger of the practice spreading to other states.

7. In my recent discussions with the Seventh Finance Commission, I had occasion to refer to this problem and to suggest that perhaps the Commission could take a view on the content to which the deficits of the states concerned were result of factors beyond their control for which special remedies may have to be devised. Deficits beyond that resulting in overdrafts that have to be cleared should clearly be recoverable, if necessary, in a phased manner. Without such a determination in a suitable manner, some State Governments will be encouraged to think that

STATE GOVERNMENTS' MINIMUM BALANCES AND LIMITS FOR
ADVANCES FROM THE RESERVE BANK

(Rs in crores)

Effective from	Minimum balances	Limits for normal or clean ways and means advances	Limits for special or secured ways and means advances	Additional special ways and means advances
1	2	3	4	5
1. 1 st April 1938	1.85	1.85 (Same as the minimum balance)	Ad hoc	—
2. 1 st April 1953	3.94	7.88 (Twice the minimum balance)	Rs 2 crores for each State	—
3. 1 st March 1967	6.25	18.75 (Three times the minimum balance)	37.50 (Six times the minimum balance)	On merits
4. 1 st May 1972	6.50	78.00 (Twelve times the minimum balance)	39.00 (Six times the minimum balance)	Ad hoc
5. 1 st May 1976	13.00	130.00 (Ten times the minimum balance)	130.00 (Ten times the minimum balance)	On exceptional occasions

	Type of Accommodation	Rate of Interest charged
1. 1 st April 1938	a) Normal ways and means advances b) Secured ways and means advances i) up to Rs 50 lakhs ii) from Rs 51 lakhs to Rs 125 lakhs	1% below the Bank Rate ¾% below the Bank Rate ½% below the Bank Rate
2. 1 st March 1967	Normal and secured ways and means advances	1% below the Bank Rate
3. 1 st May 1976	Normal and secured ways and means advances i) for the first 90 days ii) beyond 90 days up to 180 days iii) beyond 180 days	1% below the Bank Rate 1% above the Bank Rate 2% above the Bank Rate

overdrafts to any extent can be indulged in without having to take any corrective action.

With kind regards,

Yours sincerely,
I.G. PATEL

Sri H.M. Patel
Finance Minister
Ministry of Finance
Government of India
New Delhi
Encls:

The rates of interest charged by the Reserve Bank on the advances to State Governments have also undergone revisions over the years as follows:

Prior to May 1976, the rate of interest charged was differentiated by the type and/or the magnitude of the accommodation provided; thereafter, the calibration has been in terms of duration for which the accommodation was being availed of. The interest rate was fixed at the Bank Rate on overdrafts outstanding up to seven days, and from the eighth day, the rate increased by 3 percentage points; while the charges on authorized accommodation were set at one percentage point below the Bank Rate for the first 90 days, 1 percentage point above the Bank Rate for the succeeding 90 days, and 2 percentage points above the Bank Rate for the period beyond 180 days.

Under Section 21A(1) (a) of the Reserve Bank of India Act, monetary transactions of the State Governments are carried out by the Reserve Bank without reference to the cash balance positions of the concerned State Governments. Advances up to the limits specified in the agreements between individual State Governments and the Reserve Bank, referred to earlier, are meant to tide over the discrepancies between the flows of individual State Government's receipts and the flows of its disbursements. When the discrepancies are larger than the limits for advances granted to the State Government, an overdraft with the Reserve Bank emerges on its account. This happens unobtrusively as the monetary transactions of the State Governments are effected simultaneously at various treasuries, sub-treasuries and banks. It is a prescribed procedure with the Reserve Bank to draw the attention of the State Government to its overdrawn position as soon as it emerges and to call upon it to clear the overdraft within seven days of its appearance. In response to such communications from the Reserve Bank, it has now become almost a practice with the State Governments to advise the Bank that they have brought the position to the notice of the Government of India whose decisions were awaited on the requests for grant of special ways and means assistance to clear the overdrafts.

Both the Reserve Bank and the Central Government have repeatedly impressed upon the State Governments to avoid and eliminate larger continuing overdrafts by making every effort to improve their resources position, and by the practice of fiscal discipline. (The Reserve Bank's efforts in this regard include, as during August/September 1977, discussions with Finance Secretaries of the states, running overdrafts on a continuing basis.) At the time of granting assistance to clear the

overdrafts, the Central Government have all the more specifically stressed the need for fiscal discipline by the State Governments.

Regrettably, however, overdrafts have, in recent years, become a chronic feature in case of several State Governments despite the urging of the Reserve Bank and the Government of India, as also the Central Government assistance. Nor have the Central assistance and the exhortations of the Fifth Finance Commission, the Reserve Bank and the Central Government succeeded even in containing the overdrafts, much less reducing or eliminating them. The average of month-end levels of outstanding overdrafts more than doubled to Rs 86 crores during 1975 from around Rs 40 crores during 1974. It declined marginally to around Rs 84 crores during 1976, only to rebound to Rs 172 crores during 1977. During 1978 (up to May 15th), this has further increased to Rs 276 crores.

Statements 2 to 5 in the Appendix set out month-wise and state-wise figures of month-end and peak levels of overdrafts during 1976–77 and 1977–78. Between the two years, the peak levels have bounced up dramatically in case of the States of Madhya Pradesh, West Bengal, Punjab, Punjab and Bihar. The 1977–78 peak level at Rs 50 crores, Madhya Pradesh overdraft was more than seven times that in the preceding year; the West Bengal peak overdraft more than quadrupled to Rs 94 crores; the peak Punjab overdraft of Rs 71 crores more than trebled over the year, and in case of Bihar, the growth was short of double (Table 1 below). In the first month of current financial year, the peak level has further soared up to Rs 134 crores in case of West Bengal, some Rs 40 crores higher than the 1977–78 peak, and to Rs 71 crores in case of Madhya Pradesh, a rise of some Rs 21 crores over the

Table 1: Overdrafts of State Governments (Peak Level during financial year)

(Rs crores)

States	1976–77	1977–78	April '78
Bihar	48.90	90.24	84.04
Gujarat	1.81	24.71	8.56
Haryana	14.66	31.04	–
Himachal Pradesh	0.87	9.59	–
Karnataka	–	21.79	–
Kerala	29.15	34.79	–
Madhya Pradesh	6.22	49.72	71.04
Manipur	1.81	3.94	–
Nagaland	4.82	5.22	–
Orissa	12.63	14.91	–
Punjab	21.49	71.14	69.45
Rajasthan	4.22	30.72	7.27
Tripura	2.10	1.51	–
Uttar Pradesh	176.08	125.64	182.34
West Bengal	21.81	94.13	133.89

Table 2: Number of days for which overdrafts have been continuously outstanding

States	April–March		April 1978	Up to 19 May 1978
	1976–77	1977–78		
Bihar	7	217	239	256
Gujarat	2	9	7	–
Haryana	11	59	–	8
Himachal Pradesh	6	11	–	–
Karnataka	–	46	–	–
Kerala	146	123	–	–
Madhya Pradesh	4	48	63	80
Maharashtra	–	2	–	–
Manipur	16	42	–	–
Nagaland	8	37	–	9
Orissa	10	32	–	–
Punjab	15	162	184	201
Rajasthan	7	16	15	2
Tamil Nadu	–	1	–	–
Tripura	14	24	–	–
Uttar Pradesh	154	72	20	37
West Bengal	7	123	105	122

1977–78 peak. The peak levels in April 1978 are lower than the 1977–78 peaks in case of Bihar and Punjab. But Uttar Pradesh overdrafts, the 1977–78 peak in case of which was Rs 50 crores lower than that in 1976–77 has risen to a level of Rs 6 crores higher than the peak in 1976–77.

There has also been an equally disconcerting growth in the duration for which overdrafts remain outstanding (Statements 6 and 7 in Appendix present monthly date for 1976–77 and 1977–78). It will be noted from the table below that the West Bengal overdraft, the peak level of which has been rising substantially over the years, was outstanding on May 19, 1978 continuously for 122 days; the Bihar and Punjab overdrafts have been outstanding for longer duration, but at Rs 76 crores and Rs 66 crores respectively, their levels are lower than the peaks in 1977–78 and also lower than the peaks in April 1978.

The growth in the amount of outstanding overdrafts and in the duration of the outstandings has taken place despite progressive enhancements of limits for authorized accommodation by way of normal and special ways and means advances, and in spite of the increases in interest rates charged indicated earlier. In 1978, the outstanding rose sharply from Rs 122 crores at end-January to a new peak of Rs 538 crores on 14 April 1978 and stood at Rs 480 crores on May 19, 1978 with Uttar Pradesh, West Bengal, Bihar, Punjab, Madhya Pradesh, Haryana, Rajasthan and Nagaland making up the total. The overdraft position of these states together with

their authorized borrowings from the Reserve Bank as on May 19, 1978 are shown below (Table 3).

Uttar Pradesh, West Bengal, Bihar, Madhya Pradesh, Punjab and Kerala resorted to almost continuous overdrafts in 1977-78 and remain overdrawn in the current financial year, except for Kerala which cleared its overdraft in March 1978. Out of the six states, only Uttar Pradesh and Kerala were persistently overdrawn with the Reserve Bank during 1976-77.

At the end of July 1976, West Bengal had no overdraft with the Reserve Bank. It was overdrawn in September 1976, February and March 1977, but cleared the overdrafts by month-ends. West Bengal's receipts of Central loans almost doubled from Rs 117 crores in 1976-77 to Rs 231 crores in 1977-78. The rate of growth of sales tax receipts also showed a rise in that year in case of West Bengal (as also in case of Madhya Pradesh and Orissa), and receipts from excise duties, entertainment tax and land revenue also showed an improvement. And yet, since April 1977, West Bengal has been continuously overdrawn with the Reserve Bank, with the amount of the overdraft sizeable most of the time and standing at Rs 118.34 crores on May 19, 1978, and its duration generally growing even though fortunately the State was spared unforeseen natural calamities. Uttar Pradesh, on the other hand, had an overdraft of as much as Rs 102.52 crores at end-July 1976, the amount outstanding

Table 3: Outstandings as on 19 May 1978

(Rs crores)

State	Normal ways and means advances availed	Secured ways and means advances availed	Overdrafts
Uttar Pradesh	17.00	12.50	143.44 (37)
West Bengal	10.00	3.70	118.34 (122)
Bihar	7.00	3.25	75.60 (256)
Punjab	6.00	6.00	66.05 (201)
Madhya Pradesh	8.00	8.00	54.49 (80)
Haryana	3.00	3.00	13.05 (8)
Rajasthan	6.00	—	7.79 (2)
Nagaland	1.00	—	1.21 (9)
Others	16.84	6.95	—
Total	74.84	43.40	479.97

Note: Figures in brackets are number of days overdrafts are outstanding.

on May 19, 1978 being Rs 40.92 crores higher despite decline in 1977–78 in receipts from sales-tax and land revenue from the levels in 1976–77.

In the case of Bihar and Madhya Pradesh, aggregate disbursements rose faster than aggregate receipts during 1977–78. Increases in non-Plan expenditure also contributed to growth of disbursements in Bihar. Revenue expenditure in both these states rose sharply during 1977–78 largely due to increase in wages, and dearness allowance paid to State Government employees. The rate of growth of transfer of resources from the Centre to the Bihar Government decelerated from 13.5 per cent during 1976–77 to 4.6 per cent during 1977–78, mainly due to the decline in loans from the Centre. Among the State's own tax receipts, sales tax recorded a lower rate of growth of 7.1 per cent compared with 22.7 per cent during the preceding year. The deceleration in the growth rate of sales tax during 1977–78 was also observed in the case of Haryana, Karnataka, Kerala, Punjab and Rajasthan. During 1977–78, receipts of land revenue in Madhya Pradesh declined in absolute terms. The discharge of debt and interest payments as a proportion of aggregate disbursements of Punjab rose sharply from 14.7 per cent during 1976–77 to 24 per cent during 1977–78.

The above indicates that there are substantial differences in the financial behaviour and record of various State Governments influencing their budgetary position. It is interesting to note that during 1977–78 none of these states suffered from any major unforeseen natural calamity.

The persistent overdrawn positions are a reflection of continuing gaps between states' receipts and their disbursements, and in absence of unforeseen natural calamities these have to be considered as the result of less than adequate and prudent financial discipline by the States concerned. If the State Governments remain overdrawn when natural calamities are not involved, the overdraft accommodation is a draft on resources by them beyond that agreed to, by the Central Government in planning for the economy at the beginning of the financial year. Such draft, which is not reckoned in the monetary and credit arrangements for the year, has consequences for the overall level of deficit financing as well as for the distributive justice as between the States. To promote maintenance of the health of the economy, it is imperative to terminate such drafts on resources by the States.

If the Bank is satisfied that the amounts sought to be drawn by a State Government are in excess of the permissible limit, it is legally open to the Bank to dishonour cheques issued by that Government. The Fifth Finance Commission in 1969 also recommended such stoppage of payments for a State Government which failed to clear overdrafts within a specified period, when called upon by the Bank to do so. Such suspension of a State Government's payments by the Reserve Bank would, however, threaten the credit of that Government within the meaning of Article 360(1) of the Constitution of India, which provides for the declaration of a financial emergency in any part of India.

In the context of the constitutional arrangements and relationships between the Central and State Governments as evolved over the years, it is appropriate that the Central and State Governments mutually work out arrangements to clear the present overdrafts which are at an inordinately high level. On clearing the decks, these

Governments need to conform to mutually agreed arrangements in regard to the management of the finances of State Governments, so that the latter's resources match their aggregate expenditures without any State being able unilaterally to violate arrangements, in spirit, if not in letter. In devising such arrangements the question of basic imbalance, if any at present, in the resource position of the states would be considered, which in fact, is under examination of the Seventh Finance Commission. Recognition will also have to be accorded, in the arrangements mutually agreed upon between the Central and State Governments, to the circumstance that overdrafts arise either wilfully or otherwise. Overdrafts are a barometre of bad financial management, and arrangements devised should accordingly provide for incentives for efficiency in financial management, and

STATEMENT 1

Minimum Cash Balances and Limits for Normal Ways and Means Advances and Secured Ways and Means Advances availed of as on May 19, 1978

(Rs crores)

States	Minimum cash balance	Limit for normal ways and means advances	Availed of as on 19.5.78	Limit for ways and advances maximum	Special means (secured) operative	Actual availed of as on 19.5.78
Andhra Pradesh	1.00	10.00	—	10.00	9.75	—
Assam	0.40	4.00	—	4.00	3.65	—
Bihar	0.70	7.00	7.00	7.00	3.25	3.25
Gujarat	0.70	7.00	4.52	7.00	7.00	—
Haryana	0.30	3.00	3.00	3.00	3.00	3.00
Himachal Pradesh	0.20	2.00	—	2.00	0.06	—
Karnataka	0.80	8.00	8.00	8.00	8.00	6.95
Kerala	0.60	6.00	4.32	6.00	4.15	—
Madhya Pradesh	0.80	8.00	8.00	8.00	8.00	8.00
Maharashtra	1.50	15.00	—	15.00	15.00	—
Manipur	0.10	1.00	—	1.00	—	—
Meghalaya	0.10	1.00	—	1.00	0.25	—
Nagaland	0.10	1.00	1.00	1.00	—	—
Orissa	0.60	6.00	—	6.00	6.00	—
Punjab	0.60	6.00	6.00	6.00	6.00	6.00
Rajasthan	0.60	6.00	6.00	6.00	—	—
Tamil Nadu	1.10	11.00	—	11.00	11.00	—
Tripura	0.10	1.00	—	1.00	—	—
Uttar Pradesh	1.70	17.00	17.00	17.00	12.50	12.50
West Bengal	1.00	10.00	10.00	10.00	3.70	3.70
Total	13.00	130.00	74.84	130.00	101.31	43.40

STATEMENT 2
Overdrafts of State Governments, 1976-77 (As on the last working day of each month)

States	(Rs crores)											
	April	May	June	July	August	September	October	November	December	January	February	March
1. Andhra Pradesh	-	-	-	-	-	-	-	-	-	-	-	-
2. Assam	-	-	-	-	-	-	-	-	-	-	-	-
3. Bihar	@	-	-	@	-	-	-	-	-	-	-	-
4. Gujarat	-	-	-	-	-	-	-	-	-	-	-	-
5. Haryana	@	@	@	-	-	-	-	-	-	-	-	@
6. Himachal Pradesh	@	-	@	-	-	-	-	-	-	-	-	@
7. Karnataka	-	-	-	-	-	-	-	-	-	-	-	-
8. Kerala	19.65*	23.60*	12.41**	1.47	@	@	@	@	@	@	9.04	19.17*
9. Madhya Pradesh	-	-	-	-	-	-	-	-	-	-	-	@
10. Maharashtra	-	-	-	-	-	-	-	-	-	-	-	-
11. Manipur	-	0.14	@	0.48	@	@	-	0.0035	@	-	0.10	0.43
12. Meghalaya	-	-	-	-	-	-	-	-	-	-	-	-
13. Nagaland	@	0.14	@	-	@	@	-	-	2.09	-	-	4.82
14. Orissa	-	-	@	-	-	@	-	@	1.56	-	2.70	@
15. Punjab	17.99	2.28	6.97**	@	-	-	@	-	4.12	@	-	8.50
16. Rajasthan	0.37	@	@	-	-	-	3.58	@	-	-	-	@
17. Tamil Nadu	-	-	-	-	-	-	-	-	-	-	-	-
18. Tripura	1.11	0.34	@	0.17	@	@	-	-	@	-	-	0.04
19. Uttar Pradesh+	130.23*	106.26*	63.46*	102.52*	87.14*	@	36.01*	34.72*	44.03*	9.44*	32.18*	@
20. West Bengal	@	-	-	-	-	@	-	-	-	-	@	@
Total	169.35	132.76	82.84	104.64	87.62	-	39.59	34.72	51.80	9.44	44.02	32.96

NOTE: - In September 1976, all states were in credit. * Drawn throughout the month. @ Drawn during the month, but no outstandings at the month-end. ** Position as on June 28. Cleared with Central assistance on June 29. +Uttar Pradesh did not clear overdraft on June 29, 1976.

STATEMENT 3
Overdrafts of State Governments, 1977-78 (As on the last working day of each month)

States	(Rs crores)													
	April	May	June@@	July	August	Septem-ber	Octo-ber	Novem-ber	Decem-ber	Janu-ary	Feb-ruary	March	April	As on 19 May
1. Andhra Pradesh	-	-	-	-	-	-	-	-	-	-	-	-	-	-
2. Assam	-	-	-	-	-	-	-	-	-	-	-	-	-	-
3. Bihar	79.29	88.52*	66.07*	19.47	22.15*	49.54*	44.79*	13.80*	20.61*	27.59*	30.41*	28.84*	83.32*	75.60
4. Gujarat	@	-	@	4.33	@	-	@	-	-	-	-	@	@	-
5. Haryana	9.92	19.39	@	0.96	@	9.59	@	0.04	@	-	-	@	-	13.05
6. Himachal Pradesh	@	-	-	-	@	-	@	4.60	17.35	8.33*	@	@	-	-
7. Karnataka	27.43*	29.45*	31.67*	11.71*	10.69*	22.70*	20.35*	4.20*	6.90	2.59	3.72	@	-	-
8. Kerala	6.49	4.10	4.00	16.67	3.36*	-	7.06	@	5.47	-	10.66	12.13*	62.21*	54.49
9. Madhya Pradesh	-	-	-	-	-	-	-	@	-	-	-	-	-	-
10. Maharashtra	2.52	3.83	@	0.45	@	0.92	-	-	0.56	-	-	@	-	-
11. Manipur	-	-	-	-	-	-	-	-	-	-	-	-	-	-
12. Meghalaya	1.86	@	@	-	-	-	-	-	-	-	-	@	-	1.21
13. Nagaland	@	4.20	4.25*	-	-	-	1.81	3.95	14.23	0.65	-	@	-	-
14. Orissa	30.75*	32.03*	60.89*	1.43	@	4.30	19.15*	7.65*	18.22*	31.17*	36.63*	65.08*	60.40*	66.05
15. Punjab	@	5.43	7.97	4.93	@	-	-	0.84	2.36	-	-	@	3.28	7.79
16. Rajasthan	-	-	-	-	-	-	-	-	-	-	@	-	-	-
17. Tamil Nadu	-	0.82	0.67	-	-	-	-	-	@	-	-	-	-	-
18. Tripura	77.20	70.30*	71.72*	33.97*	4.40*	24.83	40.32	12.58*	6.35	20.29	23.53	7.94*	142.27*	143.44
19. Uttar Pradesh	51.24	56.10*	71.46*	20.64*	39.89*	67.75*	67.33*	3.83*	26.98	31.22*	43.64*	78.21*	123.68*	118.34
20. West Bengal	286.70	314.17	319.66	113.60	80.49	179.63	200.81	51.49	119.03	121.84	148.59	192.20	475.16	479.97
Total														

NOTE: * Drawn throughout the month. @ Drawn during the month, but no outstanding at the month-end. @@ As on June 28. On June 29, all states were in credit with Central assistance.

STATEMENT 4

Overdrafts of State Governments, 1976-77 (Peak level of each month)

(Rs crores)

States	April	May	June	July	August	September	October	November	December	January	February	March
1. Andhra Pradesh	-	-	-	-	-	-	-	-	-	-	-	-
2. Assam	-	-	-	-	-	-	-	-	-	-	-	-
3. Bihar	48.90	-	-	6.67	-	-	-	-	-	-	-	-
4. Gujarat	-	-	-	-	-	-	-	-	-	-	-	1.81
5. Haryana	4.66	3.23	2.66	-	-	-	-	-	-	-	-	5.23
6. Himachal Pradesh	0.79	-	0.24	-	-	-	-	-	-	-	-	0.87
7. Karnataka	-	-	-	-	-	-	-	-	-	-	-	-
8. Kerala	19.65	23.60	29.15	1.81	2.97	10.29	6.18	2.62	8.18	14.24	9.04	25.71
9. Madhya Pradesh	-	-	-	-	-	-	-	-	-	-	-	6.22
10. Maharashtra	-	-	-	-	-	-	-	-	-	-	-	-
11. Manipur	-	0.22	0.81	0.48	0.72	0.60	-	0.14	0.91	-	0.10	1.81
12. Meghalaya	-	-	-	-	-	-	-	-	-	-	-	-
13. Nagaland	2.04	0.14	1.20	-	1.12	0.69	-	-	2.09	-	-	4.82
14. Orissa	-	-	1.77	-	-	4.98	-	12.63	1.62	-	2.70	11.54
15. Punjab	21.49	18.00	12.83	6.70	-	-	6.86	3.43	5.09	11.05	-	18.84
16. Rajasthan	0.95	1.44	3.04	-	-	-	3.58	-	-	-	-	4.22
17. Tamil Nadu	-	-	-	-	-	-	-	-	-	-	-	-
18. Tripura	1.11	1.29	1.63	0.17	0.60	0.71	-	-	1.42	-	2.10	1.64
19. Uttar Pradesh	176.08	130.19	105.37	103.10	87.27	89.17	36.01	39.95	47.11	34.58	32.18	89.03
20. West Bengal	21.81	-	-	-	-	0.67	-	-	-	-	1.91	4.83

STATEMENT 5

Overdrafts of State Governments, 1977-78 (Peak level of each month)

States	April	May	June	July	August	September	October	November	December	January	February	March	April	Up to 15 May
1. Andhra Pradesh	-	-	-	-	-	-	-	-	-	-	-	-	-	-
2. Assam	-	-	-	-	-	-	-	-	-	-	-	-	-	-
3. Bihar	88.70	90.24	85.21	22.22	40.63	49.54	54.24	63.10	20.61	30.76	30.83	56.90	84.04	83.32
4. Gujarat	24.71	-	-	-	-	-	-	-	-	-	-	-	8.56	-
5. Haryana	16.31	19.39	31.04	7.81	0.69	-	10.40	-	-	-	-	0.95	-	6.85
6. Himachal Pradesh	0.50	-	0.96	-	-	9.59	2.22	0.15	2.01	-	-	-	-	-
7. Karnataka	7.07	1.04	-	-	2.76	-	10.82	8.52	17.35	21.79	0.47	11.29	-	-
8. Kerala	29.07	30.22	34.79	11.71	14.76	24.17	22.33	19.69	6.90	4.50	3.72	17.90	-	-
9. Madhya Pradesh	11.70	16.76	11.11	17.51	11.47	-	8.25	2.78	5.47	-	11.68	49.72	71.04	62.21
10. Maharashtra	-	-	-	-	-	-	-	0.75	-	-	-	-	-	-
11. Manipur	2.53	3.83	3.94	0.45	0.38	0.92	-	-	0.56	-	-	-	-	-
12. Meghalaya	-	-	-	-	-	-	-	-	-	-	-	-	-	-
13. Nagaland	5.22	3.66	0.79	-	-	-	-	-	-	-	-	1.91	-	1.00
14. Orissa	2.89	4.20	8.56	-	-	-	2.83	7.99	14.23	0.88	-	14.91	-	-
15. Punjab	36.08	41.24	60.89	7.77	3.03	7.21	26.24	23.73	23.63	39.33	37.61	71.14	69.45	60.40
16. Rajasthan	1.92	6.11	7.97	8.17	5.11	-	-	3.05	2.36	-	-	30.72	7.27	4.27
17. Tamil Nadu	-	-	-	-	-	-	-	-	-	-	3.87	-	-	-
18. Tripura	-	0.82	1.51	-	-	-	-	-	0.11	-	-	-	-	-
19. Uttar Pradesh	125.64	75.66	73.09	34.36	38.21	24.83	40.51	69.92	20.26	30.98	23.53	84.96	182.34	142.28
20. West Bengal	66.14	59.09	71.46	24.46	40.20	67.75	9.02	66.57	26.98	42.01	43.64	94.13	133.89	116.34

(Rs crores)

STATEMENT 6

Number of days for which overdrafts have been continuously outstanding during 1976-77

States	April	May	June	July	August	September	October	November	December	January	February	March
1. Andhra Pradesh	-	-	-	-	-	-	-	-	-	-	-	-
2. Assam	7	-	-	-	-	-	-	-	-	-	-	-
3. Bihar	-	-	-	7	-	-	-	-	-	-	-	-
4. Gujarat	-	-	-	-	-	-	-	-	-	-	-	-2
5. Haryana	6	11	3	-	-	-	-	-	-	-	-	10
6. Himachal Pradesh	6	-	3	-	-	-	-	-	-	-	-	6
7. Karnataka	-	-	-	-	-	-	-	-	-	-	-	-
8. Kerala	98*	122*	146*	6	6	7	7	7	7	19	18	42*
9. Madhya Pradesh	-	-	-	-	-	-	-	-	-	-	-	4
10. Maharashtra	-	-	-	-	-	-	-	-	-	-	-	-
11. Manipur	-	2	7	4	7	6	-	2	6	-	3	16
12. Meghalaya	-	-	-	-	-	-	-	-	-	-	-	-
13. Nagaland	7	2	7	-	6	8	-	-	7	-	-	8
14. Orissa	-	-	5	-	-	2	-	7	7	-	1	10
15. Punjab	6	7	15	5	-	-	11	-	6	7	-	14
16. Rajasthan	1	3	7	-	-	-	2	6	-	-	-	5
17. Tamil Nadu	-	-	-	-	-	-	-	-	-	-	-	-
18. Tripura	6	8	7	1	7	7	-	-	6	-	6	14
19. Uttar Pradesh	29*	53*	78* [@]	105*	129*	154*	11	36*	60*	84*	19	43*
20. West Bengal	7	-	-	-	-	1	-	-	-	-	4	6

NOTE: * Drawn throughout the month. @ Overdrafts were not cleared in June 1976.

STATEMENT 7

Number of days for which overdrafts have been continuously outstanding during 1977-78

States	April	May	June	July	August	Septem-ber	Octo-ber	Novem-ber	Decem-ber	Janu-ary	Feb-ruary	March	April	Up to 15 May
1. Andhra Pradesh	-	-	-	-	-	-	-	-	-	-	-	-	-	-
2. Assam	-	-	-	-	-	-	-	-	-	-	-	-	-	-
3. Bihar	19	44*	69*	24	50*	73*	98*	121*	146*	170*	193*	217*	239*	252*
4. Gujarat	-9	-	-	-	-	-	-	-	-	-	-	-	7	-
5. Haryana	23	48*	59	23	2	10	12	1	11	-	-	4	-	4
6. Himachal Pradesh	3	-	11	-	-	10	3	1	11	-	-	-	-	-
7. Karnataka	7	3	-	-	6	-	9	15	22	46*	1	8	-	-
8. Kerala	67*	92*	116*	26*	51*	75*	100*	123*	10	4	5	28*	-	-
9. Madhya Pradesh	17	23	22	22	48*	-	13	4	3	-	18	41*	63*	76*
10. Maharashtra	-	-	-	-	-	-	-	2	-	-	-	-	-	-
11. Manipur	13	38*	42	16	7	5	-	-	8	-	-	-	-	-
12. Meghalaya	-	-	-	-	-	-	-	-	-	-	-	-	-	-
13. Nagaland	22	37	8	-	-	-	-	-	-	-	-	4	-	5
14. Orissa	10	8	32*	-	-	-	6	12	19	5	-	8	-	-
15. Punjab	38*	63*	87*	25	6	18	43*	66*	91*	115*	138*	162*	184*	197*
16. Rajasthan	5	8	13	16	5	-	-	7	9	-	-	13	15	-
17. Tamil Nadu	-	-	-	-	-	-	-	-	-	-	1	-	-	-
18. Tripura	-	7	24	-	-	-	-	-	4	-	-	-	-	-
19. Uttar Pradesh	23	48*	72*	26*	51*	17	18	41*	17	17	15	38*	20	33*
20. West Bengal	23	48*	72*	26*	51*	75*	100*	123*	12	36*	59*	83*	105*	118*

NOTE: *Drawn throughout the month.

STATEMENT 8
Overall Surplus(+) or Deficit (-) of State Governments

(Rs crores)

	1975-76 (A/cs.)	1976-77 (R.E.)	1977-78 (R.E.)@	1978-79 (B.E.)@
1. Andhra Pradesh	+32.1	-52.9	-135.1	-77.3
2. Assam	+9.7	+7.9	-33.7	-6.6
3. Bihar	+37.4	+11.5	-2.5	+5.6
4. Gujarat	+10.3	-1.5	-11.3	-58.2
5. Haryana	-3.7	+6.9	+25.6	-34.8
6. Himachal Pradesh	+1.9	-0.4	-0.5	-4.4
7. Jammu and Kashmir	+3.7	-	-	-2.0
8. Karnataka	+5.2	-10.1	-46.5	-64.9
9. Kerala	-12.6	-22.0	-17.3	-19.7
10. Madhya Pradesh	+30.4	-0.3	-75.2	+28.7
11. Maharashtra	+30.2	+0.3	+12.0	-4.2
12. Manipur	-4.1	-1.7	+1.6	-9.9
13. Meghalaya	-2.3	+1.3	-0.4	-
14. Nagaland	-9.8	-4.2	+3.6	-0.1
15. Orissa	-2.4	+4.6	-8.9	-12.0
16. Punjab	-10.3	+26.4	+6.1	-12.9
17. Rajasthan	+1.4	-13.9	-24.9	-29.0
18. Sikkim	+0.1	-1.7	-0.2	+0.1
19. Tamil Nadu	+3.3	+1.6	-34.7	-14.3
20. Tripura	+1.9	+1.1	-5.7*	-6.3†
21. Uttar Pradesh	-33.5	+72.5	-26.5	+33.3
22. West Bengal	-14.3	+0.3	+27.1	-40.4
Total (1 to 22)	+74.6	+25.7	-347.4	-329.3

Note: @ Figures are provisional.

*Represents budget estimates.

†Projected.

disincentives in case of inefficiency, waste and profligacy. The Reserve Bank can give only a signal regarding bad financial management by a State Government; needed realignment to arrest deterioration and then to promote improvement in State Governments' financial operations should follow such signals through discussions among the concerned parties. Governor brought all the aspects of the matter to the notice of the Seventh Finance Commission in the discussion recently held at the Reserve Bank.

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D.O.No.C.169-4611

March 8, 1980

Dear Shri Venkataraman,

I wish to draw your attention to a statement made by Dr Ashok Mitra, Finance Minister, West Bengal, while presenting the State Budget on February 27, 1980. He has stated in his Budget Speech that out of the net overall deficit of Rs 43.30 crores, Rs 23.75 crores will be covered by the State's authorized credit limit with the Reserve Bank. He has also urged a review of the authorized credit limits of the State Governments with the Bank. I am quoting the relevant extracts from his speech for your ready reference:

'To repeat, the measures of additional resource mobilization indicated just now will, on the whole, provide approximately Rs 25 crores during 1980-81. This will help us to reduce the net overall deficit to Rs 43.30 crores, of which Rs 23.75 crores will again be covered by our authorized credit limit with the Reserve Bank of India. . . .

'I would also strongly urge a review of the authorized credit limits of the State Governments with the Reserve Bank of India. A new set of regulations governing these limits were unilaterally announced with effect from October 1978. These were not discussed with the State Governments, and experience over the past eighteen months has confirmed their impracticability. Particularly since the dues of the State Governments are often, for various reasons, held up by the Centre, it is important to raise this credit limit with the Reserve Bank of India. Even otherwise, it is incongruous that while, in the current year, the Union Government has floated additional short-term treasury bills amounting to around Rs 2,500 crores, or nearly 15 per cent of the size of its overall annual Budget, a State Government, such as ours, is expected to function with authorized credit limit of Rs 23.75 crores, which is barely 1.5 per cent of our total annual transactions.'

2. Since the points raised by Dr Mitra have important policy implications, I might explain briefly the nature of ways and means advances granted by the Bank to the State Governments. The Bank makes two types of advances: (a) normal or clean ways and means advances which are extended without any collateral, and (b) special or secured ways and means advances granted against the pledge of marketable securities of the Government of India. The limits for clean and secured advances respectively are equivalent to 20 and 10 times the minimum balance which each State Government has to maintain with the Bank. All the states taken together at present enjoy a limit of Rs 260 crores by way of clean advances and Rs 130 crores against special advances, making a total of Rs 390 crores, although, due to inadequate holdings of the Central Government securities by certain states, the effective total limit at present is about Rs 368 crores. In the case of the West Bengal Government, the authorized limits for clean and secured advances are Rs 20 crores and Rs 10 crores, respectively. However, owing to inadequacy of the holdings of the Central

Government securities, the State Government at present enjoys a special ways and means advances limit of only Rs 3.75 crores, the aggregate limit by way of clean and secured advances thus being Rs 23.75 crores.

3. If any State Government draws on its account with the Bank beyond the ways and means limits sanctioned to it, an overdraft emerges in its account. The Central Government and the Reserve Bank have, from time to time, devised measures to regulate overdrafts which are unauthorized. A new scheme was introduced with effect from 1st October 1978 in terms of which special loans were granted to the concerned State Governments to assist them in clearing opening deficits so that they do not become a drag on the States' resources. Simultaneously, the limits for clean ways and means advances were doubled. Under the scheme, the Reserve Bank cautions a State Government as soon as 75 per cent of the total authorized limit of ways and means advances is availed of. In the event of indebtedness of the State Governments to the Bank continuing for over forty-five days, even within the limit of ways and means advances, the Government of India initiates discussions with the State Governments at the official level and, if necessary, follow these by discussions at the level of Chief Ministers with a view to rectifying the imbalance. The Bank keeps the Central Government and the State Governments informed of the daily overdraft position. The scheme envisages stoppage of repayment on account of the State Government concerned in case its overdraft persists continuously for more than seven working days. The Central Government is consulted at every stage of the action taken in connection with overdrafts.

4. As you are probably aware, the account of the West Bengal Government with the Bank had been overdrawn for a long time—from July 2, 1979 till December 22, 1979, and again from December 26, 1979 to February 19, 1980. Recently again, the State Government had run into overdraft with the Bank from February 29, 1980 and the overdraft was cleared only on 6th March 1980 with the release of assistance from the Central Government.

5. I have gone into these details to point out that the Central Government and the Reserve Bank have been fully aware of the need for the State Governments for temporary accommodation, but at the same time are keen that no State Government should borrow from the Reserve Bank beyond the stipulated limits. Ways and means advances to the State Governments are intended to provide only short-term accommodation to enable them to tide over temporary imbalances in their receipts and expenditures. It is important that these advances from the Bank should not be treated as budgetary resources by any State Government. It appears that the Finance Minister of the West Bengal Government has, in his Budget Speech, treated the temporary ways and means advances from the Bank as a resource to meet a part of the deficit of the State Government in 1980–81. You will appreciate that this is an unjustified use of the temporary overdraft facilities provided by the Reserve Bank, and if other State Governments also follow the example of West Bengal, it will create an unhealthy precedent from the viewpoint of fiscal discipline.

6. I thought you might like to consider writing to the State Government in this connection. I also intend to send a circular letter to all the State Governments emphasizing that the ways and means advances from the Reserve Bank are intended

to meet purely temporary fluctuations in their receipts and expenditures, and should not be treated as a budgetary resource to cover budgetary deficits.

7. The suggestion made by Dr Ashok Mitra regarding the review of the authorized credit limits of the State Governments with the Reserve Bank and the reference to 'incongruous' arrangements under which Union Government can borrow against treasury bills without a corresponding facility being available to the State Government raise larger questions of federal finance. All that I would suggest at this stage is that since the limits of ways and means advances to the State Governments were raised as recently as in 1978, it does not appear necessary to review these limits so soon again. Most of the State Governments have found these limits, by and large, satisfactory.

With regards,

Shri R. Venkataraman
Ministry of Finance
Government of India
New Delhi 1

Yours sincerely,
I.G. PATEL

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Secretary

GOVERNMENT OF INDIA
MINISTRY OF FINANCE
DEPARTMENT OF ECONOMIC AFFAIRS
NEW DELHI
January 24, 1981

Dear Dr Patel,

May I invite your kind attention to Hasib's D.O. letter No. S.85-3155 dated January 5, 1981 addressed to Tiwari on the tentative estimates of investible resources for market borrowing programme in 1981-82?

2. It is observed from the estimates furnished by the Bank that the total market borrowing programme in 1981-82 will be at the same level as in the current financial year, that is, Rs 3,700 crores. We appreciate that the growth of bank deposits in the current year has been lower than anticipated and the share of investments in Government securities by EPF organizations has been reduced by 10 per cent from 1.1.1981. However, I would like to mention that the total requirement of market borrowing in 1981-82 would have to be substantially higher due to the following factors:

- (i) In computing the resources for Plan 1980-85 the Centre's share of market borrowing has been assumed at Rs 15,000 crores. This implies that after excluding the current year's market borrowing programme, Rs 12,500 crores will have to be raised in the remaining four years. This can be possible only if the Centre's net market borrowing in 1981-82 is at least Rs 2,800 crores.
- (ii) We are already committed to allow an increase of 10 per cent in the market

borrowing programme of the States and their enterprises.

- (iii) It was agreed in the meeting of the full Planning Commission held in August 1980, in which you were also present, that an additional market borrowing of Rs 1,000 crores would be raised. Subsequently, it was decided that this amount would be made available during 1980–85 to the states whose per capita income is below the national average. Therefore, the share of states in market borrowing will be much higher in 1981–82 as compared with the current year's level.
- (iv) The allocation of market borrowings for financial institutions like IDBI etc. in the current year has proved inadequate and therefore, there will be need for a step-up in 1981–82.

3. Considering the above compulsions and the need for financing the approved Plan outlay without resorting to unduly large deficit, it will be necessary to increase the market borrowing programme in 1981–82 by at least Rs 600 crores. If it is not possible to have a market borrowing programme of this order within the existing framework of SLR, the Bank may have to consider the question of raising the SLR from 34 per cent to 36 per cent; particularly because of the discontinuance of impounding of 10 per cent of additional deposits as additional cash reserves.

With kind regards,

Dr I.G. Patel
Governor
Reserve Bank of India
Bombay

Yours sincerely,
R.N. MALHOTRA

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Camp: New Delhi
February 16, 1981

My dear Malhotra

Kindly refer to your D.O.No.96/SSEA/81 of January 24, regarding the market borrowing programme for 1981–82. I have already handed over to you a note prepared in the Reserve Bank which analyses the issues involved further. We have also had a preliminary discussion on the subject. To recapitulate:

- (a) Prima facie, given the borrowing of Rs 3,800 crores for the first year of the Sixth Plan, the proposed borrowing of Rs 4,300 crores for the second year would amount to front-loading in relation to the total market borrowing of Rs 22,500 crores envisaged for the Plan period as a whole. Since borrowing in one year establishes, in practice, a presumption for a significant increase next year, any front-loading becomes, in fact, a basis for ultimately being required to exceed the Plan target.
- (b) The assumption of front-loading applies equally to the proposed borrowing for the Centre. I am not sure if it applies also to borrowing by State Governments as we have no indication of your intentions in this regard for

1981–82. I would be grateful if information on this is conveyed to us soon.

- (c) It would appear from a reading of the Plan document that, as far as financial institutions are concerned, the envisaged borrowing of Rs 3,000 crores over five years will entail virtually no step-up over the level already reached for the first year—a level, which as you know, has proved inadequate. Here there is another built-in factor inviting us to exceed the Plan target. Under this item also, therefore, it would be useful for us to know your assumptions for 1981–82 for each of the institutions.
- (d) To put it more generally, there seems to be a certain amount of built-in overestimation of the role that financial institutions should and can play in supporting market borrowing. (We will also have to examine soon what the Plan envisages by way of direct financing of Plan Schemes by financial institutions, and what it entails for the institutions.)

2. In view of the above, in our opinion, it would be prudent to keep the total market borrowing programme for 1981–82 somewhat lower than the figure mentioned in your letter. If this does not prove feasible given the presentational compulsions of the Budget, we will, of course, have to consider together the ways of honouring the assumptions in the Budget. I hasten to add, however, that the alternative suggested by you in para 3 of your letter is neither the only nor the most desirable means for ‘achieving’ the target of market borrowing. For one thing, a part of the requirements of, say, the IDBI or the State Electricity Boards, can and should be met outside the SLR requirements by special loans from the banks to them.

3. There is also the alternative, honoured by convention, of the Reserve Bank directly absorbing some more Government securities. The monetary effect of this would be the same as that of an increase in the SLR as (as already explained in the note), even a one per cent increase in the SLR will, as far as we can now foresee, require significant RBI lending to banks if their lending in turn is not to be unduly constricted. (As I have said repeatedly, contrary to the impression prevalent in some quarters even in the Ministry of Finance, the choice between banks subscribing to market loans and alternatively lending to its other clients is *not* a choice between the public sector and the private sector, but essentially between fixed capital and working capital.)

4. If there has to be additional RBI support in any case, there are good reasons for its being directly to Government loans rather than to banks to enable them to subscribe to Government loans as well as to meet their other requirements. From the point of view of the banks, it means a lesser sacrifice of income—and they can ill afford any loss in income given all their social responsibilities. From the point of view of protecting and preserving the instruments of monetary policy also, it is better that we do not render virtually ineffective the instrument of reserve requirements. As against the statutory requirements of 25 per cent the SLR has already been raised—it would appear for budgetary rather than monetary reasons to 34 per cent, and changes in SLR for budgetary reasons can only, in practice, be one-way changes. In short, while we will keep all the options open, it is by no means clear that your suggestion is the best possible alternative. As I have already explained

to you, the choice has a bearing on the forthcoming IMF negotiations also so that whatever we jointly decide, will also have to be in that perspective.

5. Finally, I hope you would not mind if I put on record what I have already mentioned orally, viz., that the last sentence of your letter can carry the implication that, in your judgement, the decision to discontinue the impounding of 10 per cent of additional deposits as additional cash reserves was not a sound one, and can, in effect, be reversed without any adverse consequences. In view of the needless controversy created around this subject and the clarifications already given to you in writing, any such inference would be clearly unfortunate, at least from my point of view. I am glad that you were good enough to dispel my doubts in this regard.

6. To conclude, we would be glad to receive the information I have requested in this letter. We will give the matter further thought, and in the light of the Budget as presented on 28th February, we will get together soon thereafter to consider how we should proceed further.

With best regards,

Yours sincerely,
I.G. PATEL

Shri R.N. Malhotra
Secretary
Government of India
Ministry of Finance
Department of Economic Affairs
New Delhi

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MEMORANDUM TO THE COMMITTEE OF THE CENTRAL BOARD

Shri M.R. Bhide, Deputy Governor, has been appointed as the Chairman of the Life Insurance Corporation till further orders. The Government of India are considering the question of appointing a successor to Shri Bhide, but it may not be possible for them to announce the appointment for some time. In the meantime, as Shri Pande has already handed over charge, the Government of India have indicated that they are anxious that Shri Bhide should be relieved as early as possible, so that he may be in a position to assume charge of his office as the Chairman of the Life Insurance Corporation.

2. I have considered this matter very carefully and I have come to the conclusion that it is not possible for the Bank to agree to the proposal that Shri Bhide should be relieved immediately of his duties and be permitted to resign his office as a Deputy Governor. He can only be relieved when his successor is appointed. Alternatively, the Government of India desire that Shri Bhide might be allowed to hold charge of the office of the Chairman of the Life Insurance Corporation in a part-time capacity, while working as Deputy Governor until such time as his successor as a Deputy Governor has been appointed. Shri Bhide is agreeable to this arrangement.

3. According to the proviso to sub-section (2) of Section 8 of the Reserve Bank

of India Act, 1934, it is open to a Governor or a Deputy Governor, to undertake at the request of the Central Government or a State Government such part-time honorary work, whether related to the purposes of the Reserve Bank or not, as may be permitted by the Central Board, if the part-time honorary work does not interfere with the duties of the Governor or the Deputy Governor, as the case may be. In view of the fact that a new Deputy Governor may be appointed very soon, and the period for which Shri Bhide may be required to attend to the duties of both the offices is, therefore, likely to be short, I recommend that the Committee, acting on behalf of the Central Board, may approve of the proposed arrangement. Shri Bhide will not draw any remuneration for his work as a part-time Chairman of the Life Insurance Corporation.

4. If the Committee accepts my recommendation, they are requested to pass the following resolution:

Resolved

That Shri M.R. Bhide, Deputy Governor, be and is hereby permitted to assume charge of the office of the Chairman of the Life Insurance Corporation and to attend to the duties of that office, while continuing to be a Deputy Governor of the Reserve Bank.

Reserve Bank of India
Central Office
Bombay

GOVERNOR
9th January, 1967

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D.O.No.G.8-108

BOMBAY
May 2, 1968

My dear Shri Naik,

I am grateful to you for the opportunity you gave me this morning to explain to you the problem we have in respect of the land at Nariman Point which we had agreed to take on a 99-year lease from the Maharashtra Government. As I told you, the rate per square metre settled with the Reserve Bank (Rs 5,000/-) is nearly ten times the rate at which Air India, The Indian Express, Mafatlals and the Shipping Corporation got their lease, and about 4.5 times as high as the rate at which the State Bank got an adjoining site. However, this is not the root cause of our anxiety. After a very close study of the matter in consultation with our Committee as well as with the Deputy Prime Minister, we feel that the original project of undertaking a major construction to accommodate most, if not all, of our offices is not one which we could or should pursue at this juncture. The capital cost of such a construction would run into Rs 4 crores or so; we have pressing needs for construction to provide accommodation for our lower paid employees. Bearing in mind our responsibilities as a public institution, specially

charged with the administration of our monetary policy, it is our feeling that our needs of office accommodation had better be catered for, by very much more modest outlays. It is on these considerations that we are anxious not to proceed with the signing of the lease or the construction of the building even though we have already spent a sum of about Rs 25 lakhs in developing the site.

I was happy to find that you showed understanding of the problem and were inclined to take a sympathetic view of our request. You took note of the fact that we have spent a fair amount of money on the development of the site and drew attention to the difficulty which you would have in accepting any settlement which should mean that the State Government, instead of receiving the rent which it expected from the Reserve Bank would, in fact, be expected to make some payments to it. I told you that once you agreed in principle to consider our request, it would certainly be possible to arrive at a settlement which would be fair to both.

You accordingly suggested that you would call a meeting along with your concerned Secretaries in order to arrive at the basis of a fair settlement. I shall be happy to attend such a meeting whenever you call it. Unfortunately, I am going out of India from the 8th May till about the end of the month; so a later date would have to be fixed for the purpose. In the meantime, Shri Damry could make available to your concerned Secretaries all the relevant data on the subject if you so desired.

With kind regards,

Shri V.P. Naik
Chief Minister
Maharashtra Government
Bombay

Yours sincerely,
L.K. JHA

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D.O.No.G.8-246

BOMBAY
November 6, 1968

My dear I.G.,

Off and on D.P.M. has expressed to me the view that the Reserve Bank should be a truly independent body and that to ensure this he would prefer to discontinue the practice of having an ex-Government servant at its head. I give this preamble in order to set down on paper some thoughts, both regarding current day-to-day relations between the Bank and Government, as well as about certain long-term aspects of the matter about which you and I have had some cursory discussions.

2. The independence of the Reserve Bank, as indeed of the Central Bank of any country, can never mean that it would follow a policy contrary to that of the Government. The Central Bank of any country must inevitably accept and implement the policies and adopt the objectives which the Government of the country has. Its independence is mainly operational within the field of

responsibility entrusted to it by law and subject to Government's overriding powers to give directives. The relationship between the Bank and the Government has, therefore, to strike a delicate balance within this framework of considerations.

3. In most countries, barring one or two solitary and uncomfortable exceptions, the Central Bank is located in the capital. The Governor meets the Finance Minister at least once a week: meetings with the Secretary of the Department as well as at other levels take place quite frequently and regularly. Most things are sorted out by discussions. The power to give directions to the Central Bank is rarely, if ever invoked.

4. In India, for purely historical reasons, the Bank is a thousand miles away from the capital. No doubt, the Governor goes to Delhi quite frequently and the Minister also visits Bombay from time to time, but the bulk of the work is by correspondence and personal contacts at other levels are, on the whole, few. What is more, with our accent on development and the necessity for controls, the areas in which both Government and the Reserve Bank take day-to-day decisions are wide and widening. As a result, quite often different views are taken on the similar problems in Bombay and in Delhi, leading to a certain lack of coordination, some overlap and duplication and a growing tendency both in the Bank and in the public to keep referring things to Government.

5. Let me illustrate what I am driving at by two examples. At the last Board meeting in Madras, it was reported that Government had decided that in the case of students going abroad on a scholarship which covered a part of their cost but not all of it, the existing practice of our releasing foreign exchange up to one-third provided at least two-thirds of the cost met by the scholarship should be abandoned, with the proviso that where part of the cost is met by scholarship the rest could be met by any external source whatever. This decision was taken by the Government without, I believe, any prior discussion with the Bank. It is also in conflict with the principle which has Government's approval that we do not allow students to go abroad if their expenses are to be met from a private source and not a body like a university or an approved foundation. Now clearly it is for the Government who lay down the policy and to make any change in it that they think fit. However, when an educational policy is settled at an inter-Ministerial meeting at which the Reserve Bank is represented, would it not be appropriate to have the convention of getting the Bank's comments before a change is made?

6. Apart from changes in policy, a large number of representations from students and others are dealt with by Government as well as at a higher level in the Bank. Usually, these are cases which are not fully covered by the existing regulations and have to be considered on merits. As there is no clear indication of the type of cases, if any, which should be dealt with by the Bank and what type of cases, if any, should be reserved for consideration by Government, there have been cases where, in respect of the same case orders passed by the Bank, have been reversed and in some cases they have been reinstated after reversal.

7. Let me go into another field. In a recent letter dealing with branches of foreign banks, Shiralkar observed that some of the localities in which foreign banks have been allowed branches in the port towns are residential areas and not business localities and so branches should not have been allowed there. Now this

is the kind of matter which is normally dealt with by the Local Boards of the Bank who are expected to know the local areas better than we in Bombay know or people in Delhi might know. Indeed, with the kind of development which has taken place in cities like Bombay and Calcutta, the definition between a residential and a commercial area is very difficult to make. But here again my point is: should we leave these things to be dealt with by Local Boards whose members have knowledge of the areas or should we try to centralize them in Bombay or in Delhi?

8. If we are to avoid confusion of this kind, it seems to me very desirable that an attempt should be made to set down on paper the kind of things which Government will decide and the kind of things which the Bank will decide. I suggest that as a first exercise, it would be better if you ask Y.T. Shah on the foreign exchange side and Shiralkar in regard to the rest of our activities (including IDBI) to try to put their ideas on the subject on paper which we can then discuss and finalize.

9. Side by side, and now I am looking to the long-term picture, we should consider whether, granted that the Reserve Bank is in Bombay and it is not feasible to change its headquarters to Delhi, there are any particular activities of the Bank which had better be located in Delhi. One could, for example, take the view that some sections of our Economic Department had better be located in Delhi. This might be more helpful to Government as well as to the Bank. Now if such a view is taken, it will not be possible to uproot all the people and move them to Delhi one fine morning. But if there is a sense of direction, one can try to have a phased plan for such a movement. Likewise, if apart from application of the rules, all decisions pertaining to foreign exchange are to be taken by Government, then it would be better for us to centralize our exchange control work in Delhi rather than in Bombay so that the officers of the Bank are constantly in touch with the Finance Ministry.

10. You may like to discuss these thoughts with Shiralkar and Shah and then perhaps when we meet we could discuss the lines on which we should proceed.

Yours sincerely,

L.K. JHA

Dr I.G. Patel

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MEMORANDUM TO THE COMMITTEE OF THE CENTRAL BOARD

Erection of two stone statues on either side of the main entrance of Reserve Bank of India building at New Delhi

The Committee of the Central Board at their meeting held on 26th April 1961 had approved that the further execution of the scheme for erection of the two statues at the entrance of the Bank's office building in New Delhi be proceeded with, at an overall revised estimated cost of Rs 2,69,600. The work of erection of these statues was taken up in December 1955 and finally completed in February 1968.

2. There was considerable delay in carving of the statues as well as in the

construction of pedestals due to non-availability of cement and proper machinery such as crane, etc. to lift up the huge stone statue pieces over the pedestal which resulted in an increase in the expenditure. The Bank has incurred a total expenditure of Rs 3,36,720.88 which exceeds the revised estimated cost of Rs 2,69,600 by Rs 67,120.88. This increase is mainly due to the following:

	Provision Rs	Actual Rs	Difference Rs
Cost of pedestals	—	35,121	35,121
Erection expenses	20,000	29,750	9,750
Exgratia payment made to Shri Ramkinkar for maintaining an establishment at New Delhi during 1964–65, incurring additional expenses etc. as a result of delay in construction of pedestals	—	17,000	17,000
Architects' fees, etc.	—	2,514	2,514
Miscellaneous	—	2,300	2,300
			66,685

3. The Committee are requested to approve of the excess expenditure of Rs 67,120.88 incurred in connection with the erection of the two stone statues and pass the following resolution at their next meeting:

Resolved

That the excess expenditure of Rs 67,120.88 incurred by the Bank in connection with the erection of the two statues at the entrance of the office building at New Delhi be, and is hereby, confirmed.

EXECUTIVE DIRECTOR

Reserve Bank of India
Central Office Premises Department
Bombay –1
Dated 24th July 1969

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MEMORANDUM FOR THE COMMITTEE OF THE CENTRAL BOARD

Subject: Appointment of Shri A. Baksi as Secretary to the Government of India, Department of Banking

The Government of India have decided to create a new Department of Banking, within the Ministry of Finance, to implement the provisions of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1969 and to look after the work relating to the nationalized and other banks, the term-lending

agencies and other financial institutions and bank credit and other allied matters generally. Government propose to appoint Shri A. Baksi as the Secretary of the new Department. Shri Baksi will naturally cease to be a Deputy Governor with effect from the date on which he takes over charge at New Delhi.

2. Shri Baksi joined the Reserve Bank of India as a Deputy Governor on 24th January 1967 and was nominated as the Vice-Chairman of the Industrial Development Bank of India with effect from 1st February 1967 under sub-section (2) of Section 6 of the Industrial Development Bank of India Act, 1964. In the normal course, Shri Baksi would have retired from Government service in July 1969 and continued to be a Deputy Governor and the Vice-Chairman of the Industrial Development Bank of India until 23rd January 1972, but in the special circumstances of this particular case, Government has decided to release him from his undertaking to retire from Government service, and I have also considered it desirable to release him from the Reserve Bank for joining the new post to which he is being appointed.

3. It will be necessary to appoint a new Vice-Chairman for the Industrial Development Bank of India, and I propose to nominate Shri B.N. Adarkar as Vice-Chairman, with effect from the date on which Shri Baksi assumes charge of his office as Secretary of the new Department.

4. The Committee is requested to pass the following:

5. The Committee considered the Governor's memorandum dated 1st September 1969 regarding appointment of Shri A. Baksi as Secretary to the Government of India, Department of Banking and passed the following resolution:

Resolved

That the Governor's memorandum dated 1st September 1969 be recorded.

The Committee place on record their high appreciation of the valuable services rendered by Deputy Governor, Shri A. Baksi to the Reserve Bank during his tenure of Office. The Committee wish him success in the new assignment.

October 14, 1969

My dear Baksi,

This is with reference to your letter No. 21-SDB/69 dated October 4, 1969, which I received in London.

2. As I told you this morning, I had put to PM my thought that rather than continue to confront Reserve Bank officers with *ad hoc* decisions on the many problems regarding their pay scales, promotion opportunities, seniority question, etc. taken by the Governor and Deputy Governor on the advice of the Chief Manager, it would be preferable to have an independent body, which will command their confidence to go into all these questions. As it is, precisely because

isolated decisions were taken on particular problems as and when they arose, we have today many obvious irrationalities which need to be ironed out by an objective impartial study of the problems. PM's response, I felt, was wholly sympathetic to this approach. I might add that before speaking to PM, I had mentioned my ideas both to L.P. Singh as the Secretary in-charge of services and to I.G. Patel who was then dealing with the banking system. They both saw merit in my approach and the latter was, in fact, present when I spoke to PM. Following this when I had my meeting with the Officers' Association on quite a number of issues which they had raised, I had told them that they would be looked into by an independent and impartial outside body, and it was in my attempt to finalize the composition of this body that I had written on 9th September to L.P. Singh to seek his views as to which ex-official would be best equipped to help on problems pertaining to cadres, promotions, etc.

3. You have expressed misgivings about the possible repercussions of our setting up a Pay Commission type of body on public sector banks and the Central Government itself. So far as the Central Government is concerned, apart from the fact that there have been at least two Pay Commissions in the past while the Reserve Bank has had none, you are doubtless aware that a third Pay Commission is under active consideration. In any event, the pay range, as explained in my letter to L.P. Singh which will be under the purview of the body that the Reserve Bank may set up, will not be going beyond the present pay range of IAS Joint Secretaries. As regards the State Bank and the nationalized banks, as you are aware, the officers even of the State Bank are in receipt of far higher emoluments than those in the Reserve Bank with the sole exception of the Heads of the two institutions. The officers' salaries in the newly nationalized banks are, if anything, a shade better. There is, therefore, no reason to apprehend that the proposed review will lend support to higher salaries in Government or in the nationalized banks. I doubt if the officers of the newly nationalized banks will ask for or welcome a Pay Commission type of study of their emoluments because they may well feel that this would lead to a downward revision of their scales to bring them in line with other public sector bodies rather than in an improvement. In any event, am I not right in thinking that it is Government's policy that when issues between employers and employees cannot be resolved satisfactorily by bilateral negotiations, an independent body should go into them and make appropriate recommendations rather than leave the matters to be the he cause of bitterness and sometimes strife?

Yours sincerely,
L.K. JHA

Shri A. Baksi
Secretary to the Government of India
Department of Finance
Ministry of Finance
New Delhi

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CONVERSION OF THE POST OF PRINCIPAL ADVISOR TO THAT OF EXECUTIVE DIRECTOR
AND PRINCIPAL ADVISOR

I have been giving some thought to the question of the long-term arrangements that should be made for the overall supervision and coordination of the work of the Economic Department and the Statistics Department. Until 1957, work emanating from the two Departments was submitted to the Deputy Governor concerned directly by the head of those Departments, the Economic Advisor. The growing importance of economic and monetary problems dealt with by those and the other Departments of the Bank necessitated the creation of a post superior to that of the Economic Advisor and located in the Central Office itself. Accordingly, the post of Principal Advisor was created in 1957.

At their meeting on 11th February 1959, the Committee of the Central Board approved the Governor's proposal to keep in abeyance the post of Principal Advisor together with that of a retiring Deputy Governor, and to create temporarily two posts of Executive Directors, to one of which the erstwhile Principal Advisor, Dr B.K. Madan, was appointed. Work from the Departments of Economics and Statistics was routed through him to the Deputy Governor and Governor.

Subsequent changes in this arrangement have been largely *ad hoc* in character and taking into account certain factors which could not be said to be of a long-term character, Dr Madan after some time became Deputy Governor and Vice-Chairman of Industrial Development Bank of India. The view was then taken that with Dr Madan continuing to be available for overall coordination of economic work, another post for that purpose at Executive Director's level was not necessary. When Shri J.J. Anjaria was appointed as Deputy Governor, again in view of his specialized knowledge and experience, and particularly as he was in a position to devote more or less whole-time attention to economic and monetary problems, no provision of a post at Executive Director's level was felt to be necessary.

Meanwhile, with the growing importance of the work done in the Economic Department and the recognition that the Department, although technically one, was engaged in a number of specialized fields of study and research, it was decided with the Committee's approval to create a number of posts at what is known as Advisors' level, the Advisors concerned being in charge of particular lines of work, such as Balance of Payments, Agricultural Finance and the like. The need for an administrative head for the Department, as a whole, and also for coordination of the work of the different cells under each Advisor led us to revive the post of Principal Advisor, keeping the post of Economic Advisor in abeyance. Thus, the Deputy Governor, Shri Anjaria, is now assisted by a Principal Advisor, with three Advisors, each in charge of a separate wing of the Economics Department and one Advisor in the Department of Statistics.

Shri Anjaria relinquishes his office at the end of February 1970. We do not know whether Government will appoint in his place another Deputy Governor who will be able to devote his whole time to the work which Shri Anjaria was doing as a Deputy Governor. The increase in the workload at Deputy Governors' level on the Banking side on account of administration and on account of financing of industry and agriculture is such that it would not be safe to assume that Shri Anjaria's successor, if and when he is appointed, will, in fact, be able to devote his whole-time attention to the problems which in fact, were, in Shri Anjaria's field of responsibilities.

Regardless of this consideration, purely from the point of view of sound organization, it seems that the appropriate long-term arrangements would be for the overall supervision and coordination of the work of the Economic and Statistics Departments to be in the hands of an Executive Director who will normally, subject to the availability of a person of adequate competence, be selected out of the Reserve Bank officers who have worked in the Economic and Statistics Departments. This will leave greater freedom and flexibility to Government in the matter of selecting Deputy Governors, and also enable the Governor to distribute the work between them according to the exigencies of situation. An appropriate designation for the post which I have in view would be Executive Director and Principal Advisor. The Committee's approval to these proposals is sought.

Shri V.G. Pendharkar, at present Principal Advisor, is in my opinion and that of the Deputy Governors eminently suitable for appointment to the new post, and the Committee is requested to approve this appointment. Shri Pendharkar is, at present, devoting most of his time to the work of the Banking Commission of which he is the Member-Secretary. With the assumption of the higher responsibility in the Bank, we would expect him to devote some more time to the Reserve Bank's work than he is doing at present. Suitable arrangements in this behalf will be made in consultation with the Chairman of the Banking Commission and Government.

If the Committee agrees, it is requested to pass the following resolution:

Resolved

That the proposal contained in the Committee considered the Governor's memorandum dated 23rd February 1970 regarding conversion of the post of Principal Advisor to that of Executive Director and Principal Advisor and passed the following resolution:

Resolved

That the proposal contained in the Governor's memorandum dated 23rd February 1970 for the creation of the post of an Executive Director be approved, and that the person appointed to it should be entitled to the same terms as to emoluments and perquisites and other benefits, as are admissible to the other Executive Directors

Resolved further

That Shri V.G. Pendharkar now Principal Advisor be appointed to the new post of Executive Director with effect from 1st March 1970.

Resolved further

That the post of the Principal Advisor be held in abeyance.

Reserve Bank of India
Central Office
Department of Administration and Personnel
Bombay

GOVERNOR
23rd February 1970

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MEMORANDUM TO THE COMMITTEE OF THE CENTRAL BOARD ON APRIL 4, 1970
TERMS AND CONDITIONS OF APPOINTMENT OF SHRI ADARKAR AND
SHRI JAGANNATHAN AS GOVERNOR

Necessary arrangements have been approved by the Central Government. Shri B.N. Adarkar will take over from me as the Governor until the date he is due to retire, namely 14th June, 1970. Thereafter, Shri S. Jagannathan, at present, India's Executive Director in the I.B.R.D. at Washington will be the Governor of the Reserve Bank of India for the full term of five years. Under sub-section (2) of Section 8 of the Reserve Bank of India Act, the salary and allowances of the Governor will have to be determined by the Central Board with the approval of the Central Government. As a meeting of the Central Board is not likely to take place before 13th July 1970, I suggest that the Committee may consider the terms and conditions of service indicated below and if they agree, authorize me to communicate them to Government.

2. Shri Adarkar should draw the salary which I have been getting, namely Rs 4,500/- per mensem and the pension equivalent of Government's contribution to his provident fund in respect of the period of his service under Government will be deducted from his pay. Shri Adarkar has indicated that he does not want to shift to the Governor's official residence, and that he would continue to occupy his present house. As the Governor is normally entitled to a free furnished house at Bombay and suitable accommodation in Calcutta, I recommend that no rent need be recovered from him, for the period of his appointment as Governor, for the flat at Bombay or for the use of the Governor's house at Calcutta. Shri Adarkar will be entitled as Governor to the use of a bigger car for official duties, and will be able to use this car for private purposes on payment of Rs 125/- per mensem. He will continue to be entitled to leave, medical facilities and provident fund contribution from the Bank on the same terms and conditions as at present, but if owing to the exigencies or service or in the public interest, any portion of

the admissible leave is not availed of during his tenure of office, he should be able to carry forward the leave to be enjoyed after the date of his retirement as Governor.

3. Sri Jagannathan will, be usual, draw a salary of Rs 4,500/- per mensem subject to income tax and without any retiring gratuity, the pension, if any, being held in abeyance. As he will be resigning from Government service before taking up his appointment as Governor, the pension, if any, which is commuted by him and the pension equivalent of the death-cum-retirement gratuity, if any drawn by him, will be reduced from his salary. He will be permitted, according to the practice, which has normally been followed, to contribute to the Reserve Bank of India Employees' Provident Fund under Regulation 5 (iii) and the Bank will contribute monthly to his provident fund account a sum equal to $8\frac{1}{3}$ per cent of his pay. Shri Jagannathan, like all his predecessors, will be entitled to a free furnished house in Bombay and suitable accommodation in Calcutta and also to the free use of the Bank's car for official duties. In case the car is used for private purposes, he will make a contribution of Rs 125/- per month to the Bank. Leave for a total period of four months, inclusive of the time spent in proceeding to and from the destination will be available to him. While proceeding on ordinary leave, he will be eligible to draw fare to and from the place of domicile in India, by air or by rail by the highest class of accommodation available for himself, and for each member of his family actually travelling. If necessary, the leave may be availed of in more than one spell, but the leave fare will be admissible on one occasion only. Pay during the period of ordinary leave will be Rs 4,500/- per mensem, subject to income tax and also the deduction, if any, on account of pension or the pension equivalent of any gratuity.

4. If owing to the exigencies of service, or in the public interest any portion of the admissible leave is not availed of during the tenure of his office, Shri Jagannathan will be entitled to such unutilized leave after his retirement from the Bank. The pay during the period of leave availed of on or after the date of retirement as Governor will be the pay, which might have been admissible, if the leave had been availed of before the date of retirement.

5. If the Committee approves of my proposals, it is requested that the following resolution may be passed:

Resolved

That the proposals in the Governor's memorandum dated 27th April 1970 be approved and that he be authorized to convey them to the Central Government for their approval.

GOVERNOR

Reserve Bank of India
Central Office
Bombay
Dated 27th April, 1970

November 22, 1976

MEMORANDUM TO THE COMMITTEE OF THE CENTRAL BOARD
Halting Allowance for the Governor, Deputy Governors and Executive
Directors

The existing rates of halting allowance for the Governor, Deputy Governors and Executive Directors which were last revised in November 1973 are as follows:

- | | | |
|--|---|--|
| 1. Governor | : | Rs 35/- per diem <i>or</i> actual hotel expenses |
| 2. Deputy Governors and
Executive Directors | : | Rs 30/- per diem <i>or</i> actual hotel expenses |

The Directors of the Central Board are also paid halting allowance (known as 'subsistence allowance') at the rate of Rs 35/- per diem; this rate was also revised in November 1973.

2. There is, however, a special provision in respect of the Directors of the Central Board that if, at the request of the Director, the Bank arranges for accommodation at a hotel for the day or days of the meeting, the Director shall, for that period, draw halting allowance of Rs 10/- per diem to cover incidental expenses. In the absence of any such provision in the case of Governor and Deputy Governors, who are also the Directors of the Central Board, the Governor and Deputy Governors, when provided with hotel accommodation at the Bank's cost, are often out of pocket on account of certain incidental items of expenditure defrayed by them in the course of their stay at the outstation. It is, therefore, proposed that as in the case of the Directors of the Central Board, Governor and Deputy Governors may also be paid halting allowance at the reduced rate of Rs 10/- per diem to cover such incidental expenses when they stay in hotels, the bills for which are paid by the Bank. It is also proposed to pay the halting allowance on the same basis to Executive Directors who attend the meetings of the Central Board.

3. The Committee are requested to approve of the above proposal and to pass the following resolution at their next meeting:

Resolved

That the proposal contained in paragraph 2 of the Governor's Memorandum dated 22nd November 1976, be and is hereby, approved.

GOVERNOR

Reserve Bank of India
Central Office
Department of Administration and Personnel
Bombay 400001
Dated 22nd November 1976

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MEMORANDUM TO THE COMMITTEE OF THE CENTRAL BOARD
Appointment of Executive Director

As I had mentioned to the Committee earlier, it is proposed to appoint Shri W.S. Tambe, now Joint Secretary to the Government of India, Ministry of Finance, Department of Economic Affairs, as Executive Director in the Bank. I have discussed the matter further with the Government and Shri Tambe. The Government have agreed to release Shri Tambe, and the latter is prepared to join us on our usual terms. He would, however, prefer to voluntarily retire from the Government before joining the Bank's service. For this purpose, he has already moved the Government and is likely to be relieved as from 31st May 1978. It is, therefore, proposed that Shri Tambe may be appointed in the Bank's service with effect from last June 1978.

2. On being appointed in the Bank, Shri Tambe will be governed by the Reserve Bank of India (Staff) Regulations, 1948. He will draw a fixed pay of Rs 3,025/- per mensem as admissible to the Executive Directors, besides being eligible for other allowances and facilities, as admissible to other Executive Directors in the Bank. He may also be reimbursed the expenditure involved in shifting his personal effects, etc. from New Delhi to Bombay, to the extent admissible under the Bank's rules. In respect of other conditions of service, he will be subject to the rules applicable to the Senior Officers of the Bank. His pension and death-cum-retirement gratuity as sanctioned by the Government, will be kept in abeyance till his retirement from the Bank's service.

3. The Committee of the Central Board are requested to approve of the above proposal and to pass the following resolution at their next meeting:

Resolved

That the proposal contained in the Governor's Memorandum dated 15th May 1978 regarding appointment of Shri W.S. Tambe as Executive Director in the Bank be and is hereby approved.

GOVERNOR

Reserve Bank of India
Central Office
Department of Administration and Personnel
Bombay
Dated 15th May 1978

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MEMORANDUM TO THE COMMITTEE OF THE CENTRAL BOARD
Creation of Posts of Executive Directors

Since Shri C.S. Divekar relinquished his appointment as Deputy Governor on 11th November 1965, Shri D.R. Joshi, Executive Director, has been attending to his duties, in addition to his own. As the Committee is aware, Shri Joshi was appointed as Executive Director on a tenure basis for a period of five years, and this period is due to expire on 31st May 1966, when he would vacate his post (he has been permitted to avail of the leave due to him after that date, that is, with effect from 1st June 1966).

2. I have been considering the question of consequential arrangements and have come to the conclusion that a second post of Executive Director be created. A post of Deputy Governor is, at present, vacant. It is necessary, therefore, to make arrangements for filling the two posts of Executive Directors.

3. I propose to appoint Shri N.D. Nangia, who has been Chief Manager of the Bank, against one of these posts. As Chief Manager, Shri Nangia draws a fixed pay of Rs 2,700/- per mensem and I recommend that as Executive Director his pay may be fixed at Rs 2,750/- per mensem. He will continue to draw the allowances to which other Senior Officers of the Bank are entitled, viz., Local Pay, House Allowance and the Bank will also contribute to his Provident Fund at 10 per cent of his basic pay (including Local Pay) as heretofore.

4. As regards the second post of Executive Director, I have arranged to obtain from the Government of India, on deputation, the services of Shri R.K. Seshadri, who belongs to the Indian Economic Service, and is at present working as Director of Banking in the Department of Economic Affairs in the Ministry of Finance, New Delhi. Shri Seshadri is drawing in the Government a pay of Rs 2,000/- per mensem. The Government of India have proposed that he may be paid, in addition, a special pay of Rs 250/- per mensem and I recommend accordingly. In addition, he will be eligible to draw the allowances as admissible to him in the Government, which at present are Rs 100/- per mensem Dearness Allowance and Rs 75/- per mensem City Compensatory Allowance. He will be provided with a Bank's flat and garage for which he will be charged 10 per cent of his pay (including special pay) as rent. During the period of his deputation, the Bank will pay to Government the usual leave salary and pension contribution payable by a foreign employer in respect of Central Government Officers on deputation. The Government of India have agreed to place his services on deputation for a period of three years from the date he reports himself for duty to the Bank, and the other terms of his deputation will be on the usual basis.

5. If the Committee approve of the proposals made above, they are requested to pass the following resolution:

Resolved

That the proposals made in Governor's Memorandum dated 3rd May 1966 to create two posts of Executive Directors and to fill them by appointment of

Sarvashri N.D. Nangia and R.K. Seshadri, the latter on deputation basis from the Government of India, on terms stated therein, be and are hereby, approved.

GOVERNOR

Reserve Bank of India
Central Office
Bombay
3rd May 1966

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Camp:
May 13, 1968

My dear Damri,

Just before I left Bombay, Mitra told me that in the Conciliation proceedings in Delhi over our emergency procedure relating to currency needs, we had claimed that this was a management matter while the workers were claiming that even in management, workers should have a say.

I felt a little concerned subsequently as to whether in a place like Delhi our case would be adequately represented without some special guidance from Bombay. I therefore tried to get a message relayed to you and to Shiralkar via London. I do not know if you got it in an intelligible form.

My concern is over the point that if we allowed the issue to become one of principle, namely, that the matter rests with the management, we might get the Conciliator to say that the workers participation in management is a desirable thing. I would much rather argue the case more frontly by saying that so long as we had to import currency paper, it was desirable for us to ensure that any usable currency that went back into circulation rather got destroyed. Now that currency paper is available indigenously, we cannot afford to spend more on examining used currency than what we would save as a result of such examination.

Secondly, I would put the management angle in a somewhat different perspective. No one could argue that 'P' form regulations should continue even if that were otherwise unnecessary, merely to ensure that the clerks working on it are kept employed. The same kind of consideration must govern whether or not some scrutiny of old currency notes is or is not necessary. What we do recognize is that any change in our procedure should not cause any unemployment or retrenchment.

Thirdly, the continuance of existence procedure not only means expansion of staff but even more on new buildings and vaults. The economy to be achieved by changing our procedure is not merely on the wage bill.

You may have already done the necessary briefing of our representative on the Conciliation but I thought having a little time on my hand in Stockholm, of writing to you about the matter.

I am also enclosing a copy of a note which I have recorded following my talks in Paris. You may like to pass it on to your other colleagues and to Narasimhan.

Kindly ask Narasimhan to send me copies of papers prepared for the next meeting of the Standing Committee of the National Credit Council.

With kindest regards,

Yours sincerely,
L.K. JHA

Shri P.N. Damri
Deputy Governor
Reserve Bank of India
Bombay 1

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APPOINTMENT OF DIRECTORS TO THE CENTRAL BOARD OF THE RESERVE BANK OF INDIA

Government of India issued a notification regarding the appointment of Shri Kamaljit Singh as a Director of the Central Board of the Reserve Bank of India on 25th June 1968. The text of the notification reads as follows:

‘In exercise of the powers conferred by sub-section (4) of Section 12 read with clause (c) of sub-section (1) of Section 8 of the Reserve Bank of India Act, 1934 (2 of 1934), the Central Government hereby nominates Shri Kamaljit Singh, Managing Director, Marketing Division, Indian Oil Corporation, 254-C, Dr Annie Besant Road, Prabadevi, Worli, Bombay 25 as a Director of the Central Board of the Reserve Bank of India vice Dr Triguna Sen.’

The Legal Department was consulted about the reference to Section 12(4) which is the section which deals with the casual vacancies in the Board. On a strict interpretation, therefore, the appointment of Shri Kamaljit Singh would cover only the unexpired portion of Dr Triguna Sen. This means that Shri Kamaljit Singh’s appointment would legally be for a period of four days, that is up to 30th June 1968.

I sent a telex to Delhi yesterday and also spoke to Shri D.N. Ghosh about this and the Government of India, I understand, now propose to issue another notification appointing Shri Kamaljit Singh for the full term as from July 1, 1968.

For information.

N. NARASIMHAN
26.6.1968

Governor may kindly see the telex message below. I understand that PM has approved of the appointments of all the four persons as directors of the Central Board of the Bank.

2. Shri M.P. Chitale is, at present, a director of the Dena Bank. Under Section 10(1) (e) of the Reserve Bank of India Act, this is not technically a disqualification for appointment on our Board, as the Dena Bank is not a banking company, but is a statutory corporation like the State Bank of India. There have been instances

in the past of directors of the State Bank of India being also directors of the Reserve Bank, but latterly we have been discouraging this practice. While it is not necessary to discriminate against the nationalized banks, as compared with the State Bank of India, we may as a matter of policy in future, ask the directors, both of the State Bank and the nationalized banks, to resign from the boards of these banks before they join our Board.

3. On this assumption, we may ask Shri Chitale to resign from the Board of Dena Bank. The question does not arise in the case of Dr Verghese Kurien as he is not now connected with any bank.

R.K. SESHADRI
29.8.1972

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S.M. Joshi

THE GOVERNOR
RESERVE BANK OF INDIA
BOMBAY 1
1170 Sadashiv Peth
Poona 30
12th August 1972

Dear Shri Jagannathan,

I am extremely distressed to write this letter. You must have been reading the controversy about my acceptance of the Board Membership. Surely it was a welcome opportunity for me to study the working of the economic system of our country from the nerve centre of finance. It was really very educative for a social worker like me.

I did not know what to do when the National Committee of my party asked me to withdraw from the Board. After careful consideration of the issues involved, I came to the conclusion that it is in the interest of disciplined political life in our country to resign. So long as I am a member of the Party, I must submit to their directives. I do not know whether you would agree with me in this regard. I know the loss is mine.

I do not know to whom the letter of resignation should be addressed. Therefore, I am sending it to you. Kindly forward it to the appropriate authorities and oblige.

I express my sense of gratitude to you and your colleagues for the kindness shown to me all these days.

I hope the friendly relationship developed in this short period will continue in future also.

With kind regards,

Reserve Bank of India
Bhagatsingh Road
Bombay 1

Yours sincerely,
S.M. JOSHI

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MEMORANDUM TO THE COMMITTEE OF THE CENTRAL BOARD

Rates of Halting Allowance for the Governor and Deputy Governors

The existing rates of Halting Allowance for the Governor and Deputy Governors are as follows:

1. Governor : Rs 30 per diem *or* actual hotel expenses
2. Deputy Governors : Rs 25 per diem *or* actual hotel expenses

When the Governor and Deputy Governors stay in the Governor's flat at New Delhi, Calcutta and Madras, they are paid halting allowance at 50 per cent of the rates applicable to them.

2. The basic rates of halting allowance, viz. Rs 30/Rs 25 for the Governor and Deputy Governors respectively, were fixed by the Committee of the Central Board at their meeting held on 29th May 1935, but the provision for payment of actual hotel bills was introduced in 1947, with the approval of the Committee of the Central Board at their meeting held on 23rd July 1947. The Directors of the Central Board are paid 'subsistence allowance' at the rate of Rs 30 per diem for each day of travel or day or days of the meeting.

3. The rates of halting allowance fixed for the Governor and Deputy Governors have remained unchanged since 1935. The Central Government has revised the rates of halting allowance of Senior Government officials of comparable status on more than one occasion in the course of the past one decade or so. The last revision took effect from 1st January 1971. At present, the Secretaries to Government draw more halting allowance (that is, Rs 28 p.d.) than the Deputy Governor at places like Bombay, Calcutta and other centres classified along with it. The rates of halting allowance for all cadres of officers of the Bank have also since been increased, effective from 30th May 1973, in pursuance of the recommendation of the Cadre Review Committee, headed by Justice J.L. Nain, then a Sitting Judge of the Bombay High Court and now the Chairman of Monopoly and Restrictive Trade Practices Commission. Halting Allowance is now admissible to senior officers drawing pay above Rs 2,000 p.m. on the following basis: When such officers make their own arrangements, they are paid halting allowance @ Rs 30 per diem for all cities with a population of 3 lakhs and above, State Capitals, hill stations, and when they stay in hotels, they are paid halting allowance at the rate not exceeding Rs 50 per diem, subject to the production of duly receipted hotel bills. The Executive Directors of the Bank who are entitled to draw halting allowance at the rate applicable to the higher grade of officers of the Bank are now being paid halting allowance at Rs 30 per diem or actual hotel expenses.

4. Inasmuch as the Deputy Governors draw halting allowance at a lower rate, it creates an anomalous position. To remove this anomaly, it is proposed that:

- (i) the rate of halting allowance for Deputy Governors may be raised to Rs 30 per diem or the actual hotel expenses;
- (ii) Likewise, the current rate of halting allowance for the Governor (which is

Rs 30 per diem) may be raised to Rs 35 per diem. The same rate may also be applied for payment of 'subsistence allowance' to the Directors of the Central Board.

- (iii) In accordance with the 'split rate' of halting allowance admissible to the higher officers of the Bank who are provided with Bank accommodation when on tour in Category I areas (State Capitals, hill stations and towns with population of 3 lakhs or more) viz., the charge paid to the Bank for the accommodation plus Rs 20, a similar rule may be made applicable to Deputy Governors and the Governor.

5. It is proposed that the above rates of halting allowance may be made effective from 1st November 1973.

6. If the Committee approves of the above proposals, it is requested that the following resolution may be passed:

Resolved

That the proposals contained in paragraph 4 of the Governor's Memorandum dated 20th November 1973 be and are hereby approved and that the new scales of the daily allowances for the Governor, the Deputy Governors and Directors of the Central Board be increased as proposed in the said paragraph with effect from 21st November 1973.

GVERNOR

Reserve Bank of India
Central Office
Department of Administration and Personnel
Bombay 1
Dated 20th November 1973

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No. B-4

MEMORANDUM TO THE CENTRAL BOARD

Revision of the rates of halting allowance for the Local Board Members of the Reserve Bank of India and reimbursement of taxi-fares to and from the airports in the case of Members of the Local Boards and Directors of the Central Board.

In terms of the resolution passed by the Central Board at their meeting held on August 22, 1964, members of the Local Boards of the Bank are reimbursed travelling expenses on the following scale for attending meetings of the Local Boards:

(i) *Air, rail or steamer fares:*

- (a) If the journey is performed by rail, one fare by the route actually used by the highest class of accommodation actually availed of, plus one-third class fare for a servant, if taken.

- (b) If the journey is performed by steamer, one fare by the highest class of accommodation actually availed of, plus one fare by the lowest class for a servant, if taken.
- (c) If the journey is performed by air, one fare by the class of accommodation actually availed of, plus the excess freight paid on personal luggage, and one-third class fare by rail for a servant, if taken.
- (ii) *Personal accident aviation insurance cover:*
Up to Rs 1,00,000 if taken.
- (iii) *Halting Allowance:*
At Rs 20 for each day of travel and the day or days of the meeting.

2. It was also decided by the Board in 1964 that while the halting allowance for directors of the Central Board nominated under Section 8(1) (b) and 8(1) (c) or 12(4) of the Reserve Bank of India Act for attending meetings of the Central Board and its Committees should continue to be Rs 30/- per day for each day of travel or of the meeting, the Bank might, on a request from a director, arrange for accommodation at a hotel for the day or the days of the meeting, in which case the halting allowance payable would be at a reduced rate of Rs 10/- per day to cover incidental expenses. This facility was not, however, granted to members of the Local Boards.

3. The rates in the case of the members of the Local Boards are now unrealistic and will have to be revised. At its meeting held on November 21, 1973, the Committee of the Central Board approved of the proposal to increase the rate of halting allowance payable to the Deputy Governors, having regard to the rates of halting allowance now admissible to senior officials of the Central Government of comparable status and the revision of the rates of halting allowance in the case of the Bank's officers, in pursuance of the recommendations of the Cadre Review Committee. The halting allowance in the case of Deputy Governors was increased from Rs 25 to Rs 30 per day. The halting allowance for the Governor was raised from Rs 30 to Rs 35 per day, and the subsistence allowance in the case of the directors was also raised from Rs 30 to Rs 35. Decision was also made for the payment of the allowance of other cases at a split rate, namely, the lodging expenses admissible to the Bank plus Rs 20 per day.

4. In the light of these decisions, it is proposed that the halting allowance in the case of members of Local Boards should be increased from Rs 20 per day to:

- (i) Rs 30/- per day in case the members are able to make private arrangements,
or
- (ii) The actual expenses for boarding and lodging, subject to a maximum limit of Rs 50/- per day, or
- (iii) Rs 50/- per day, if a sum of Rs 25/- or more has been incurred on account of expenses separately for lodging, or
- (iv) The actual expenses on account of lodging plus Rs 20/- per day, if the actual expenses for lodging are less than Rs 25/- per day,
whichever of these rates might be relevant.

5. In view of the withdrawal by the Indian Airlines of the facility for free transport to and from the airports, and the increase in taxi charges recently, it

has been represented by some members of the Local Boards that the expenses incurred by them on account of transport to and from the airport should also be reimbursed. This claim appears to be reasonable and it is proposed to reimburse the actual coach or taxi fares for two journeys, one to the place of temporary residence in the city or the office, and the other back from that place or office to the airport. Any other expenses on conveyance or taxi fares, if any, will be met within the daily allowance, as it is now proposed to be revised.

6. It has been our practice to provide on request transport to and from the airports in the case of the directors of the Central Board. In view of the difficulties which are likely to be experienced by the directors, it is proposed that the actual coach or taxi fares as the case may be, to and from the airports should also be reimbursed to them, in addition to the daily allowance.

7. If these proposals are approved, it is requested that the following resolution may be passed:

Resolved

Revision of the rates of halting allowance for the Local Board Members of the Reserve Bank of India and reimbursement of taxi fares to and from the airports in the case of Members of the Local Boards and Directors of the Central Board.

The Board considered the Deputy Governor's memorandum No. B-4 dated 29th January 1974 regarding the revision of the rates of halting allowance in the case of Members of the Local Boards, and the reimbursement of actual cases incurred by the Members of the Local Boards and the Directors of the Central Board for journeys to and from the airport, and desired that in the case of member or director using his own car for journeys to and from an airport, mileage at the rate applicable to the officers of the Bank might be paid. Subject to modification, the Board

Resolved

That the proposals in the Deputy Governor's Memorandum No. B-4 dated 29th January 1974 be and are hereby approved.

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The Reserve Bank of India (Maintenance of Services) Ordinance, 1979 No. 4 of 1979

PROMULGATED BY THE PRESIDENT IN THE THIRTIETH YEAR OF
THE REPUBLIC OF INDIA

An Ordinance to provide, in the interests of the general public, for the prohibition of strikes in the Reserve Bank of India.

Whereas Parliament is not in session and the President is satisfied that circumstances exist which render it necessary for him to take immediate action.

Now, therefore, in exercise of the powers conferred by Clause (1) of Article

123 of the Constitution, the President is pleased to promulgate the following Ordinance:

Short title, extent and commencement

1. (1) This Ordinance may be called the Reserve Bank of India (Maintenance of Services) Ordinance, 1979.
- (2) It extends to the whole of India.
- (3) It shall come into force at once.

Definitions

2. In this Ordinance,

- (1) 'Bank' or 'Reserve Bank' means the Reserve Bank of India constituted under Section 3 of the Reserve Bank of India Act, 1934 (2 of 1934).
- (2) 'Strike' or 'Strike in the Reserve Bank' means the cessation of work by a body of persons employed in the Reserve Bank acting in combination or a concerted refusal or a refusal under a common understanding of any number of persons who are or have been so employed to continue to work or to accept employment, and includes:
 - (i) refusal to work overtime where such work is necessary for the discharge of the functions of the Bank,
 - (ii) any other conduct which is likely to result in, or results in, cessation or substantial retardation of work in the Bank.

Power to prohibit strikes in the Reserve Bank

3. (1) If the Central Government is satisfied that in the interests of the general public it is necessary or expedient so to do, it may, by order, prohibit strikes in the Reserve Bank.
- (2) An order issued under sub-section (1) shall be published in such manner as the Central Government considers best calculated to bring it to the notice of the persons affected by the order.
- (3) An order issued under sub-section (1) shall be in force for six months only, but the Central Government may, by a like order, extend it for any period not exceeding six months if it is satisfied that in the interests of the general public, it is necessary or expedient so to do.
- (4) Upon the issue of an order under sub-section (1):
 - (i) No person employed in the Reserve Bank shall go or remain on strike,
 - (ii) Any strike declared or commenced, whether before or after the issue of the order, by persons employed in the Bank shall be illegal.

Dismissal of employees participating in illegal strikes

4. Any employee of the Reserve Bank who commences a strike which is illegal under this Ordinance, or goes or remains on, or otherwise takes part in any such strike, shall be liable to disciplinary action (including dismissal) in accordance with the same provisions as are applicable for the purpose of taking such disciplinary action (including dismissal) on any other ground under the terms

and conditions of service applicable to him in relation to his employment.

Penalty for illegal strikes

5. Any person who commences a strike which is illegal under this Ordinance or goes or remains on, or otherwise takes part in any such strike, shall be punishable with imprisonment for a term which may extend to six months, or with fine which may extend to one thousand rupees, or with both.

Penalty for instigation, etc.

6. Any person who instigates, or incites other persons to take part in, or otherwise acts in furtherance of, a strike which is illegal under this Ordinance shall be punishable with imprisonment for a term which may extend to one year, or with fine which may extend to two thousand rupees, or with both.

Penalty for giving financial aid to illegal strikes

7. Any person who knowingly expends or supplies any money in furtherance or support of a strike which is illegal under this Ordinance shall be punishable with imprisonment for a term which may extend to one year, or with fine which may extend to two thousand rupees, or with both.

Power to arrest without warrant

8. Notwithstanding anything contained in the Code of Criminal Procedure, 1973 any police officer may arrest without warrant any person who is reasonably suspected of having committed any offence under this Ordinance.

Ordinance to override other laws

9. The provisions of this Ordinance and of any order issued thereunder shall have effect notwithstanding anything inconsistent therewith contained in the Industrial Disputes Act, 1947 (14 of 1947), or in any other law for the time being in force.

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Submitted to the Central Board Committee at the meeting held on 23rd January 1980

MEMORANDUM TO THE COMMITTEE OF THE CENTRAL BOARD

Rates of Halting Allowance payable to Governor and Deputy Governors

1. With the approval of the Committee of the Central Board, the rates of Halting Allowance payable to the Officer staff of the Bank were revised effective 26th December 1979. Consequently, the rates of Halting Allowance payable to the Senior Officers are now more than what are payable to the Governor and Deputy Governors. This obviously is anomalous.

The existing rates of Halting Allowance payable to Governor and Deputy

Governors are as under:

Governor : Rs 35/- per diem *or* actual hotel expenses
 Dy. Governors : Rs 30/- per diem *or* actual hotel expenses

(Directors are paid the same amount as Governor and these rates came into effect from 21st November 1973.)

As compared to the above, Senior Officers of the Bank are now paid Rs 50/- per diem towards Halting Allowance.

2. We are currently reviewing the rates of Travelling/Halting Allowances payable to Directors in connection with attending the Board meetings, and our proposals in this regard will be placed before the next Central Board meeting. Nevertheless, in order to remove the above-stated anomaly, it is proposed to enhance the existing rates of Halting Allowance payable to Governor and Deputy Governors with retrospective effect from 26th December 1979.

3. At present, Governor and Directors of the Central Board are being paid Halting Allowance at slightly higher rate than Deputy Governors. Since Deputy Governors are also Directors of the Central Board, it is proposed to dispense with the disparity. Accordingly, Governor and Deputy Governors may be paid Halting Allowance at Rs 50 per diem. The existing facilities of reimbursement of actual hotel charges will continue to be in force.

If the Committee approve of the above proposals, it is requested that the following resolution may be passed:

Resolved

That the proposals contained in Deputy Governor's Memorandum dated 21st January 1980 regarding payment of halting allowance to Governor and Deputy Governors be and are hereby approved.

P.R. NANGIA
 DEPUTY GOVERNOR

Reserve Bank of India
 Secretary's Department Central Office
 Bombay
 Dated: 21st January 1980

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D.O.No.G.8-131

BOMBAY
 June 17, 1968

My dear I.G.,

You and I have, from time to time, exchanged thoughts about the possibilities of simplifying those of our foreign exchange regulations which impinge on individuals. I thought I should indulge in some further loud thinking on the subject this time on paper, and with somewhat more concrete approach as to the lines on which we should advance.

Quite frankly, I feel that it is not too advisable for the Reserve Bank to get

involved in a large number of problems which concern individuals rather than corporate bodies. Basically, we are organized to deal with the latter, specially the banks. When any clearance is sought from the Reserve Bank, we expect certain data and certain forms to be filled which may be child's play with a bank but seem formidable to average citizen. No less important is the consideration that a very high percentage of the time of Reserve Bank officials in Exchange Control is taken up in dealing with individual cases involving petty sums. As such cases have, as a rule, to be dealt with urgently, there is consequent delay in dealing with more important cases involving large sums of foreign exchange. Simplification and streamlining of procedures will not only result in public satisfaction but also enable much greater concentration of attention and effort on larger transactions pertaining to foreign exchange earnings and expenditure.

If we are to have the requisite degree of simplification, then a somewhat broad judgement has to be exercised. One reason why the machinery works so slowly is that the rules are very complicated because at the technical levels, both in the Ministry and in the Reserve Bank, in an attempt to plug all possible loopholes, too many tests and conditions have been imposed, each of which can be justified on merits and can only be relaxed on wider considerations of administration and policy.

I would begin with our travel regulations first. A lot of travel is pre-planned. The intending traveller can apply for necessary permission to go and, given reasonable efficiency, the Reserve Bank can say yes or no to him in good time. At the same time, we must recognize that there are occasions when a person has to travel on an emergency basis. Our officers try their best to deal with such cases as quickly as possible, but there are some problems which cannot be surmounted without a considerable and, in my view, unnecessary, expansion of staff. If an unforeseen disaster compels a man to travel within twenty-four hours, he can get the requisite clearance if he is a resident of Bombay or Delhi, but it is very difficult for a man in Cuttack or Ahmedabad to get such clearance in less than forty-eight hours at the very least. Then again, if a weekend or holiday intervenes, the time process gets lengthened. It is not easy to find a solution to this problem, but it should weigh with us in considering travel restrictions as a whole.

Let us first consider the procedures involved in giving P form clearance. The regulations are complex, and in many cases Reserve Bank's offices outside Delhi cannot pass the final orders, and in some cases a reference has to be made to Government and may require inter-ministerial consultation. True, there has been some delegation of late. What I am suggesting is whether a more radical simplification is not possible.

The P form restrictions were introduced because we felt that about half the people who go out of India without applying for foreign exchange, do so by relying on black market foreign exchange. What has happened over the years is that because a number of people have tried, from time to time, to bluff us, we have evolved a series of regulations which are unduly irksome to the honest man and carry little conviction to the public at large. For any simplification to be considered, we have to recognize that no set of rules can be completely fool-proof, or shall I say

knave-proof! What we have to see is that hundreds of honest people do not feel harassed merely because there are a few crooks around.

The class of people who can afford to travel for pleasure at their own expense is very limited, and even more limited is the class of people who can afford to finance themselves by buying 10 rupees to the dollar. This being so, I cannot help feeling that for certain types of people, we could well afford to be liberal in granting P form clearance without foreign exchange without undertaking a detailed scrutiny to see if the invitation from abroad is genuine. I think artists and musicians as well as professors and scientists are the kind of people who could be given P form clearance fairly freely without any verification of the authenticity of the invitation on which they are going abroad.

Another class of cases where I think a wholesale relaxation could be made is those whose fare is paid in foreign exchange by somebody or some agency outside India. It is not unreasonable to suppose that if the fare has been paid abroad, then living expenses would also be provided. It could, of course, be argued that some people might be able to get the foreign exchange even for their fare in the black market; my feeling is that for the sake of this view it is not worth our subjecting everyone to rigorous screening procedure, and in any event suspicious cases should better be looked after *ex post facto* by Enforcement Branch than by our time-consuming procedures. There remains another class of cases which may be deemed to be objectionable on political grounds. I feel that the task of denying clearance to anyone on political grounds is not one which should be entrusted or operated through the Reserve Bank, and the exchange control mechanics. Cases challenging the legality of such restrictions are increasing. If the Judiciary has struck down some of the restrictions regarding the issue of passports, I think the P form regulations, if they are used for purposes other than of exchange control, would also become targets of successful challenge. Actually, the class of people who get their foreign exchange paid from outside are often invitees of international institutions.

Leaving aside the type of cases referred to above, we come to the class of applicants about whom no inference, one way or the other, is possible on apriori grounds. We deal with them by defining the kind of host whose hospitality they could accept; the degree of relationship has been revised from time to time. I do not think courts will uphold us in taking decisions such as hospitality from an uncle being eligible for some time, then becoming ineligible for another period, and then becoming eligible again. I would prefer a straightforward course of allowing anyone to go abroad on hospitality but not oftener than once in three years unless there is some reason for the additional journey. Such an approach would mean reasonable freedom to travel on the basis of hospitality once in three years. Additional journeys will have to be justified by giving grounds for undertaking them. The kind of ground I have in mind is that often an Indian couple living abroad is in need of a female relation when the wife is expecting a child.

What I am asking you to do is not to agree with what I have said in the preceding paragraphs in specific terms, but you might like to sound D.P.M. as to

whether he sees merit in this approach as a whole. If he does, then we can attempt to formulate something more specific for his consideration and orders.

In regard to travel with foreign exchange, clearly our foreign exchange position, being what it is, we cannot become more liberal. However, on the procedural side, I think what is irksome is asking an individual to render accounts and produce vouchers for his expenses abroad. This does not apply across the board, but where it does, it can unnecessarily add to our work and create a feeling of harassing the individual. The simplification I would aim at is to eliminate such scrutiny except perhaps where large releases are involved for specific purposes.

Travel apart, there are two other types of cases where simplification is called for. Firstly, there are Indians living abroad and earning abroad. Their rupee account gets frozen in the sense that they can only spend limited amounts out of it, without Reserve Bank's permission. Credits to their account are also watched. Both these operations are to see that they do not convert their rupees into foreign exchange in the black market, or conversely they do not sell their foreign exchange earnings in the black market against credits in rupees. I think this control could, with suitable instructions, be delegated to the banks where the individuals have their accounts so that references to the Reserve Bank are reduced to the minimum, and if they do come, they come from the banks and not from the individuals. More latitude than at present would be justified.

Another class of Indians are those who have permanently gone abroad. They may have been allowed to take a part of their assets if they were entitled to it or they may not have been allowed anything at all. In either event, part or whole of their assets remains frozen in India. Here again, the accumulation of rupee funds in India owned by foreigners is not something which I consider desirable. If the process continues over time, the amounts may become uncomfortably large. While we prevent them from taking out the money in the form of foreign exchange, it seems to me that we should provide for some ways in which the money starts decumulating without any pressure on our reserves. I have two thoughts on the subject. One is that we may allow them to use their rupees for buying tickets to come to India and to spend as much time as they like here. Secondly, we may allow them to buy Indian goods of specified categories and values to be taken out with them or sent to them.

Finally, there are cases of Indians who have balances abroad with Reserve Bank's approval. If they want to change their form of holding or investment, they have to come to the Reserve Bank for permission. Here again, a wider view has to be taken. One possible view would be to get all these monies repatriated to India or at least as much of it as in excess of a specified minimum. This may mean some accrual to our reserves, but as this is a once-for-all character, the view has been taken not to undertake this operation until and unless we are facing a dire emergency. On this view, I feel that an individual who wants to change his investment from one form to another so as to improve his return on it should be given the requisite freedom to do so.

I do not know whether I have covered all the types of cases in which the Reserve Bank gets involved with individuals, but I would like you to think over the

points I have made and to let me have your reactions as to the directions in which you feel we should proceed.

Yours sincerely,
L.K. JHA

Dr I.G. Patel
Special Secretary
Department of Economic Affairs
Ministry of Finance
Government of India
New Delhi

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D.O.No.G.8-130

BOMBAY
June 17, 1968

My dear I.G.,

This is just in the nature of a postscript to the talks we had when you came here for a day.

I take it that on Bhide's note regarding speculation in certain shares you will be sending him a reply and that we, for our part, should proceed on the lines of the discussion which you had with me and Adarkar.

On the import policy paper I have one or two further thoughts. I had told you to include newsprint among the things where, by developing domestic capacity, we can achieve substantial savings in foreign exchange. I would add that even when I was in the Industry Ministry, two projects for this purpose had been approved—none of them has made any progress as far as I know. It is the kind of thing which could well be undertaken in the public sector. The Soviet Union could well supply the equipment and technology. If they want to do it on a grand scale and harness the timber resources of the Himalayas, we might achieve something worthwhile in a very much wider perspective. Alternatively, even if we have to import the pulp for it, I believe the savings in foreign exchange are likely to be substantial.

Another potential for saving in foreign exchange lies in developing the production on a commercial scale of the pyrites as a substitute for sulphur in units producing sulphuric acid. This again was a project I had dealt with in the Industry Ministry. It is in the public sector and in the hands of a corporation. I do not know how fast it is moving.

However, the more important point on import policy which I think calls for some study is an attempt to project what are the likely levels of imports of the things on the liberalized list in the absence of restrictions. I find it difficult to believe that the low level of imports in the last two years can be attributed entirely or mainly to the recession. An item-wise study is, to my mind, called for to identify which particular declines could be said to have been due to recessionary conditions and also the order of likely increase in these items if industrial production shows an increase of 5 per cent this year. I think we may well find that

the increased outlay would be nominal, and in any event if we want the higher production unavoidable. If this view is correct, then it would have a major bearing on any decision which we take to tighten import control, and also the areas to which the tightening should apply. So long as imports were being kept down, it was arguable that any increase in import licensing would mean an increase in imports. This assumption would not be equally valid in today's conditions. Also as a tool for future policy decisions an attempt to forecast import requirements may well prove worthwhile. I am trying to have some kind of a study made here, but probably someone like Marathe might be better placed to do so. Having two parallel exercises would not be a bad thing.

Finally, quite some time back Baksi had written a letter to Shiralkar about the policy which IDBI should adopt in respect of well-established industrial units seeking finance for expansion or diversification. It would help if a reply to it came pretty soon so that account could be taken of it in preparing papers for the IDBI Board.

Dr I.G. Patel

Yours sincerely,
L.K. JHA

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BOMBAY
September 16, 1968

My dear Ramaswami,

Your D.O.No.2606-EA/68 dated 7th September 1968 asking for my comments on ARC's recommendations which concern the Department of Economic Affairs and the Reserve Bank. As I am going out of India in a couple of days, I am hurriedly jotting down a few comments on some of these recommendations. At the same time, I am sending down the papers to Adarkar who will, in consultation with the concerned people in the Bank, send you further comments without being inhibited by the views which I express.

Recommendation No. 40: I think it is desirable to have a Government resolution on foreign investment. As you know, there is a twenty-year-old statement by the Prime Minister on the subject, and one or two subsequent pronouncements by Finance Ministers. A new statement is clearly called for, in order to bring the statement in line with current policy, to consolidate at one place points which are covered by different statements and above all to provide a clear formulation in terms of which both Government officials and intending investors can operate. As it is, every decision assumes an *ad hoc* character and if criticized has to be defended without the sheet anchor of a policy statement. In regard to the substance of such a statement, Government have much more to contribute than the Reserve Bank. However, in the present context of a large number of old British interests wanting to sell out, I think we should reserve to ourselves some freedom to regulate such repatriation over a number of years. We cannot be bound forever by assurances given by the UK when the bulk of our sterling balances were

blocked, and when they had given us the facility that capital repatriation would be debited to the blocked account and not to the free portion. I.G. is aware of my thinking on the subject.

Recommendations 45 to 51: I do not want to comment on these in detail and shall content myself with a few observations. It may not be altogether practicable to defer a C.G. Committee decision till the very end because a lot of the arrangements necessarily follow and cannot precede a C.G. clearance. So far as foreign exchange for studies abroad is concerned, the real point to ensure in order to avoid inconvenience, dislocation and harassment is that any change of policy which intensifies restrictions is notified one clear academic year before it is enforced. Stability for three years will not, by itself, help. It is inadequacy of notice which is important. Regarding accounts for medical treatment, like all other types of rendering of accounts, there is the danger of the persons concerned, particularly those who have not used medical treatment as an excuse, being subjected to a lot more of botheration than would be justified. Perhaps, we should have a certain scale of living expenditure which we would admit without details. For medical expenses, we can insist on vouchers. However, I would regrettably add that doctors, in many countries, charge a higher fee if receipts are asked for. So improved accounting may well mean higher foreign exchange expenditure. Finally, you may wish to have a look at the noting on the file relating to Tarlok Singh's medical expenses where both sides of the case have been argued. Regarding publication of something like a red book to indicate policies and procedures governing release of foreign exchange for invisible items, I am wholly in favour of it. I know it will mean a lot of botheration to the Reserve Bank staff. I also know that there is an Exchange Control Manual, but something which the public can have access to and understand is clearly necessary.

Recommendation 52: Calling for the abolition of P form control is the most controversial proposal. I.G. has asked me for my personal views. I shall try to see if I can put them down on paper before I go.

Recommendation 53: I agree that further simplification of capital issues procedures would be desirable. Regarding the closed season, my own thinking and the current thinking in the Reserve Bank is in favour of much greater freedom than has existed so far. Adarkar will write to you after discussing with Seshadri. However, I want to make one point. I think knowledge of the parties who are intending to make capital issues is available not only to Government but also to the public. The sanctions given by the Controller give useful information to the Stock Exchange and to the investors. I feel, therefore, that while application for permission should be dispensed with over as wide a range as possible, a system of giving notice to the Controller for a reasonable period before the issue would be worthwhile retaining. Whether it should be one month or three months is a matter which the experts can advise on better.

Shri V.K. Ramaswami
Economic Advisor, Department of Economic Affairs
Ministry of Finance, Government of India, New Delhi

Yours sincerely,
L.K. JHA

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BOMBAY

September 17, 1968

My dear I.G.,

You had asked me for my personal views on the ARC recommendation for the abolition of the P form. Hence this letter written in Delhi a couple of days before I leave and without any figures which you will have to call for from Bombay.

Let me say, at the outset, that basically the decision has to be at a high political level because the dominant considerations are not technical in nature. Whether we decide to retain the control, to tighten it, to liberalize it or to abolish it, there will be some undeserving beneficiaries of the policy and some who will suffer through no fault of theirs. Ultimately, the question will be one of deciding whether it would be better in the event to let a lot of unscrupulous people benefit in order that no honest man should suffer, or whether we should keep the restrictions as tight as possible to avoid abuses even though it may cause discontentment and perhaps even harassment to innocent citizens. A relevant factor to remember is that it is not a problem affecting the masses but only certain classes which include intellectuals, artists, politicians, businessmen and their wives as well as smugglers and blackmarketeers.

In any examination of the question it is important to remind ourselves that the P form was not intended to save foreign exchange. It was intended to prevent the acquisition of foreign exchange in the blackmarket for meeting travel expenses. Therefore, the question how much foreign exchange does the P form save is not relevant. What is relevant is an estimation of the illicit acquisition of foreign exchange which it prevents. Such an estimation is very difficult to make for obvious reasons. However, it would be correct to say three things. Firstly, the amount of illicit foreign exchange going into travel with or without P form and on account both of people who travel on a P form and people who travel with foreign exchange is a relatively small fraction of illicit foreign exchange involved in other operations, particularly smuggling. Secondly, it is by no means easy to say whether, if travel became freer, the totality of foreign exchange going into illicit channels would increase or there would only be a diversion from say smuggling to travel. Thirdly, with the very high cost of air tickets after devaluation and taking into account the fact that such a large number of Indians do manage to go out of India each year on business, for health, as members of delegations and under P form clearance, perhaps the pent-up demand for travel on account of people who would and could acquire foreign exchange in the blackmarket is not as great today as it was sometime ago. Having said all this, the fact does remain that if P form were to be abolished, there would be an increase of an indeterminate order in the amount of blackmarket foreign exchange being used for travel.

Looking at this question from another angle, I cannot help expressing the personal view that the location of a P form control in the Exchange Control Department of the Reserve Bank has not been an altogether happy decision. The

Reserve Bank is certainly equipped to exercise exchange control. P form regulations basically are a form of control on travel rather than on foreign exchange. True, the objective of the control is linked with foreign exchange. Measures through which the objective is to be attained are administrative in character. Thus, whether a man should be allowed to go on an invitation from a first degree blood relation or a third degree blood relation, whether he should accept the hospitality of a foreign government or a foreign institution or a foreign individual are matters in which Reserve Bank has little contribution to make. All the relevant decisions are, therefore, taken by the Government. Yet the administration is with the Reserve Bank. Because of the pressing nature and urgency of dealing with these applications, I feel the Exchange Control Department of the Reserve Bank is sometimes unable to bestow adequate attention to important cases in which large sums of foreign exchange are involved. In retrospect, I cannot help feeling that the regulation of travel is more appropriately a matter for Governmental agencies than for the Bank which could have been consulted occasionally if there were questions where it had any special knowledge. Whether in the event of a decision to retain P form control as a long-term feature of our policy, a change should be made is a matter on which I have no definite views. In the previous examination of the question of P form in the Reserve Bank in the recent past, our view has been that as a long-term measure it would not be justifiable to maintain a total ban on travel except for specific purposes for which adequate foreign exchange could be released such as business, education and health. Thinking has been in the direction of allowing individuals to go out not more than say once in three years with a limited amount of foreign exchange on austerity standards and for a limited period of time. Such a long-term solution may have to be introduced sooner or later, but whether we should do it so now or not is a matter on which no one can be dogmatic. However, if we decide to do so, then I would not see any reason to abolish the P form. We could tell people that opportunities to go abroad are not restricted to those who can conveniently arrange an acceptable invitation, and the discipline of going out only once in a few years could be applied to those who go on P form or with foreign exchange alike—unless, of course, there were specific reasons to justify additional journeys.

On the other hand, if the view were taken that we cannot promise even a limited amount of foreign exchange at an interval of number of years to anyone for the asking, then I would favour the idea of permitting anyone to go out on any invitation but only once in say three years. This would do away with the criticism that those who are in the fortunate position of having a close relation abroad can make many journeys while those whose relationship may be even more intimate, but is perhaps one degree removed in terms of blood, cannot have similar opportunities. In other words, a possible formula might be that anyone can go out on any invitation once in three years and no one can go out oftener unless there is justification for it. If this line of approach is accepted, a fair amount of detailed work will have to be done in the Bank to ensure a proper enumeration of the kind of cases where more frequent journeys would be permissible.

If neither of these alternatives is considered desirable at present, then we could certainly apply our minds to what I would call administrative simplification. The object of such a study would be to avoid harassment to those who do not know the rules too well and abuse by those who know how to get round the rules. If this approach is accepted, then we would need to set up a small working group of the officers of RBI and the Government. Such a study team would have to have a clear sense of direction because if such a group gets overzealous in plugging loopholes, it may end up by making the restrictions much more complicated and stringent, and if it starts with the exclusive object of removing hardship in all genuine cases, it may recommend a degree of liberality which may not be acceptable.

You will observe from what I have stated above that I have recommended no definite course but merely referred to a number of alternatives. This is because, as I said at the beginning, the decision has to be based on considerations which are wider than those which come within my purview. However, if I were to look at the question in a somewhat wider perspective than of exchange control, I would say that much of the criticism and discontent against P form control stems from two factors. Firstly, people feel specially in view of the judicial pronouncement on passports that a total embargo on going out of India except for certain approved purposes or in terms of rigid P form control, is not justified as a long-term measure. Secondly, there is the growing feeling that if P form is meant to stop access to the blackmarket for travel purposes, it is not really serving its purpose. For the kind of people who are wealthy enough to afford a holiday abroad with blackmarket foreign exchange are anyhow able to go out by complying with our procedures and requirements, and the kind of people who could not possibly afford such a jaunt are not able to go because the evidence of hospitality which they can produce does not conform to the kind of regulations which have been prescribed. As you know, in order to weed out spurious invitations, only a few categories of people are accepted as eligible hosts. Hospitality from people outside these categories, even though they may be men completely above suspicion, is ruled out because it is difficult for a controller to distinguish between one foreigner and another on the basis of his reliability and integrity. The real question is how far Government are prepared to go to remove these two grievances.

If you were to ask me that if I had the responsibility of taking a decision, my answer would be that I would announce that a P form, without question, will be given to all those who have not gone abroad for the last five years. I would see how many people take advantage of this in the coming eight to nine months. If the number is not too large as I suspect it would not be, then one could develop this policy further and we may well find that once the pent-up passion for travel is gone, the number of people who have to be restrained through P form may become too insignificant for the control to be continued. Once the size of the problem is known, one could even think in terms of giving a few pounds per traveller who would otherwise have to go out of the country more or less as a destitute. As it is, of the P form applications received, a very high percentage is being approved because they conform to our requirements. No one can say

whether this is because knowing our regulations those who are not covered by them do not apply, or whether this is because the number of ineligibles wanting to travel on P form is not too large. No amount of studies can provide an answer to this question. A bold experiment would be justified. In the light of it, we could shape future policy.

Dr I.G. Patel
Special Secretary to the Government of India
Ministry of Finance
Department of Economic Affairs
New Delhi

Yours sincerely,
L.K. JHA