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ADMINISTRATIVE REFORMS COMMISSION

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REPORT

ON

THE RESERVE BANK OF INDIA

AUGUST, 1969

IMPORTANT

This is the report of the Working Group appointed by the Administrative Reforms Commission. The report of the Commission on the same subject is a separate document.

Manubhai Shah

28, Sunder Nagar
*New Delhi-*11

Dated August 4, 1969

My dear Shri Hanumanthaiyaji,

As you would recall, in consultation with the former Deputy Prime Minister and Finance Minister of India, Shri Morarjibhai Desai, you and late Shri Harish Chandraji Mathur had asked me to examine the working of the Reserve Bank of India and make a report to you and the Central Government.

As the examination had to cover a very vital institution of our economy, I had to consult a large number of bankers, economists and official experts. I should place on record the very valuable discussions and co-operation that I received from Shri L.K. Jha, the Governor of the Reserve Bank of India, Sarvashri B.N. Adarkar, A. Baksi, J. J. Anjaria and P. N. Damry, the Deputy Governors of the Reserve Bank of India, the senior officials of the Ministry of Finance and numerous leading bankers and economists of the country. I must also place on record the very valuable discussions and the benefit of your advice and the suggestions given by the late Shri Harish Chandra Mathur who had a great interest in economic and political problems of our country.

Now that I have completed the examination and in the wake of nationalisation of the 14 leading banks of the country, I have the pleasure to forward to you my recommendations on this matter. The original idea of the Deputy Prime Minister and Finance Minister and yourself was that as the subject matter concerns the foremost financial institution of India, you would like the report to be presented to the Finance Minister for such use that the Central Government may like to make of these suggestions and that it will be more like an informal report rather than a regular report of the Administrative Reforms Commission.

I, therefore, hope that you will kindly arrange to forward it to the Prime Minister of India (who also heads the Finance Ministry). If any further discussions on any of our suggestions and recommendations are needed, may I assure you that I will always be at the disposal of the Central Government.

May I also place on record my deep appreciation of the very arduous task that Dr. B.D. Sharma has performed in studying the banking institutions of the leading countries of the world and in preparing the voluminous reports of our detailed discussions with different experts and economists, and in finalising our report.

Thanking you and with kindest regards,

Yours sincerely,
Sd/- MANUBHAI SHAH

Shri K. Hanumanthaiya,
Chairman,
Administrative Reforms Commission,
New Delhi.

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Part I

THE RESERVE BANK OF INDIA

Growth and Functions

The Royal Commission on Indian Currency and Finance, which reported in 1926, had recommended the setting up of a Central Bank. After much debate, the Reserve Bank of India was established on April 1, 1935 as a shareholders' bank with the objective of "regulating the issue of Bank notes ond the keeping of reserves with a view to securing monetary stability in India and generally to operate the currency and credit system of the country to its advantage."

2. In terms of this objective the Reserve Bank was specifically called upon to fulfil the following functions—

1. Management of money.
2. Providing banking facilities to Government.
3. Acting as banker to other banks.
4. Administration of exchange control.
5. Collection and publication of financial statistics.

3. Since its inception in 1935, the RBI gradually expanded both in terms of the volume as well as diversity of business. Notes in circulation increased from Rs. 164 crores in 1935-36 to Rs. 1228 crores in 1947-48. The total assets of the Banking Department went up from Rs. 49 crores to Rs. 545 crores. The bulk of the increase (Rs. 392 crores) in the assets was, however, due to sterling balances.

4. The major step taken by Government after Independence was the nationalization of the Reserve Bank. The Reserve Bank of India (Transfer to Public Ownership) Act 1948 empowered the Central Government to issue such directions to the Bank as were deemed to be in public interest.

5. The general superintendence and direction of the Bank's affairs are vested in the Central Board of Directors consisting of the Governor, 4 Deputy Governors, 4 Directors nominated under section 8(1)(c) and 1 Director nominated under section 8(1)(d) of the Reserve Bank of India Act 1934. The Governor, Deputy Governors, and other Directors are nominated by the Central Government. For each of the four regional areas, viz. western area, eastern area, southern area and northern area, there is a Local Board with headquarters in Bombay, Calcutta, Madras and New Delhi. The Local Boards consist of 5 members appointed by the Central Government to represent, as far as possible, territorial and economic interests and the interests of cooperative and indigenous banks. The Directors of the Central Board of Directors nominated under section 8(1)(b) represent the four Local Boards. The Local Boards advise the Central Board on such matters as may be generally or especially referred to them and perform such duties as the Central Board may delegate to them.

6. The Chairman of the Central Board of Directors and the Chief Executive of the RBI is the Governor. He is assisted by 4 Deputy Governors and 2 Executive Directors each of whom is in charge of certain spheres of operations of the Bank. There are, at present, 13 Departments at the Central Office, viz., Department of Administration and Personnel, Accounts and Expenditure Department, Premises Department, Inspection Department, Secretary's Department, Legal Department, Exchange Department, Department of Banking Operations and Development, Department of Non-banking Companies, Industries Finance Department, Agricultural Credit Department, Economic Department and Department of Statistics. Each Department is headed by a Chief Officer, Manager or Adviser. The Departments are sub-divided into divisions which are under the charge of Deputy Chief Officers or Directors.

7. The RBI has established regional offices in Bombay, Calcutta, Madras, New Delhi, Kanpur, Nagpur and Bangalore, besides offices at Hyderabad, Jaipur, Patna, Trivandrum, Ahmedabad, Gauhati, Bhubaneshwar, Ludhiana and Srinagar. The RBI maintains offices of the Issue Department in its regional offices and also at Gauhati and Hyderabad. It maintains currency chests with branches of the State Bank of India, and Government Treasuries and sub-Treasuries. The currency chests are of particular assistance to Government because they enable treasuries to work with relatively small balances. They also provide remittance facilities to banks and the public.

8. The RBI Act stipulates that the operations of the Bank relating to Note issue are conducted through the Issue Department and those relating to general banking business through the Banking Department. The Issue Department issues or receives Bank notes only in exchange for other Bank notes or such coins, bullion or securities as are permitted by the Act to form part of the reserve. The assets of the Issue Department consist of gold coin, gold bullion foreign securities, rupee coin and rupee securities. The aggregate value of the gold coin, gold bullion and foreign securities should not, at any time, be less than Rs. 200 crores, the value of gold coin and gold bullion being not less than Rs. 115 crores. The bulk of the assets (about 90 per cent) consists of Government of India rupee securities.

9. The Banking Department primarily performs banking functions of the RBI. The assets of the Banking Department consist of (i) balances held abroad; (ii) loans and advances to Government, Scheduled Commercial Banks, State Cooperative Banks, and financial institutions; (iii) bills purchased and discounted; and (iv) investments. The liabilities of the Banking Department include (i) paid-up capital: (ii) reserves National Agricultural Credit (long-term operations) Fund; (iii) National Agricultural Credit (Stabilisation) Fund; (iv) National Industrial Credit (long-term operations) Fund; and (v) deposits by Central Government, State Governments, Scheduled Commercial Banks and State Cooperative Banks. The assets and liabilities of the Banking Department reflect the type of business undertaken by the RBI both as a central banker as well as a developmental and promotional institution.

10. Sections 20, 21, 21A & 20B of the RBI Act make it obligatory for the RBI to transact Government business. As a banker to the Central Government and State Governments, the RBI accepts moneys, makes payments, carries out exchange, remittance, and other banking operations, including the management of public debt.

11. The RBI is also authorised to make, in terms of section 17(5) of the RBI Act, ways and means advances to Central and State Governments, repayable within three months. These advances are not subject to any maximum limit or any specific interest rate but are usually regulated by agreements with the Central and the State Governments.

12. The work relating to Government business is entrusted to the Public Accounts Department of the RBI. It receives and disburses moneys on behalf of the Central Government, the State Governments and various Government Departments including Railways and carries out their exchange and remittance transactions.

13. An important function entrusted to the RBI is the management of public debt. Being a banker to the Central Government as well as State Governments the RBI is able to coordinate the borrowing programmes to ensure highest subscription. Usually, the Central Government floats short-term and long-term loans and the State Governments, medium term loans. The period of maturity, the rate of interest, issue prices, timing of the issue etc., are determined in consultation with the RBI. The unsold part of the Central Government securities is held by the RBI. Normally, the RBI does not hold any substantial amount of State Government securities.

14. The RBI also sells treasury bills to the Public. Until July 1965, treasury bills were sold by weekly auctions. Thereafter they have been sold on tap throughout the week.

15. The RBI, as a Central Bank is responsible for maintaining an orderly monetary and credit system in the country. The RBI discharges this responsibility through its statutory powers of supervision and control over the Commercial Banking System which is the most important constituent of the money market. The latter consists of:—

1. Scheduled Banks (paid-up capital and reserves exceeding Rs. 5 lakhs).
2. Non-Scheduled Banks.
3. Non-banking non-financial Companies and non-banking financial companies accepting deposits from the public.
4. Un-organised sector made up of 'indigenous' bankers.

16. Scheduled Banks are eligible for certain facilities and, in turn, have to comply with the directives of the RBI. Apart from the State Bank 14 other major banks with deposits of over Rs. 50 crores have been nationalised bringing about 90 per cent of the banking sector under direct state control. The RBI also exercises control over non-scheduled banks. At the end of March 1968, there were 85 scheduled banks with aggregate deposits of Rs. 3890 crores, Non-scheduled banks numbered about 20 in January 1968 with deposits

of about Rs. 100 crores. Their number has been considerably reduced because of amalgamation and mergers.

17. As a banker to the banks, the RBI has adequate powers to regulate their operations and to ensure that the interests of the depositors are safeguarded. The RBI's approval is necessary for the setting up of a new bank or for opening of new branches or for amalgamation and merger of existing banks. The RBI carries out *periodical inspections to check any irregularities on the part of the* banks.

18. A major instrument of credit control is the Bank Rate. This is the rate at which scheduled banks get financial accommodation from the Reserve Bank.

19. The RBI increased the Bank Rate from 3 to 3½ per cent in 1951, to 4 per cent in 1957, to 4½ per cent in 1963, to 5 per cent in 1964, to 6 per cent in 1965 and back to 5 per cent in 1968. Until recently, the RBI did not intervene directly in regulating the structure of money rates. But since 1964 the RBI also stipulates the minimum deposit rates to be allowed and the maximum advance rates to be charged by the scheduled banks.

20. In January 1952 the RBI introduced a Bill Market Scheme to enable banks get demand loans against the security of usance promissory notes of their constituents. The accommodation sought by the banks is confined only to the busy season, neither has it been very significant. As such the impact of the bank rate has been only nominal.

21. Through open market operations the RBI can regulate the liquidity in the economy as well as the interest on Government securities. 'Switch' operations can also be used to make the interest structure more balanced. The open market operations of the RBI, are, however, restrained by the fact that its portfolio is over-burdened with Government securities.

22. The RBI has the power to direct scheduled banks to maintain a part of their total deposits with itself or in approved securities. The net liquid assets include cash in hand, balances with the RBI, balances with other banks in current accounts, investments in Government and other approved securities *less* borrowing from the RBI, ARC, IDBI and SBI. The RBI has the power to vary the liquidity ratio from 25 per cent to 40 per cent. An increase in the liquidity ratio reduces banks' capacity to give credit to industry, trade or individuals.

23. The RBI can also, through its selective credit control policy, issue directions to commercial banks stipulating margin requirements and the overall credit limits and thereby weaken demand for particular commodities. This helps to dismount, the inflationary pressures on prices. Since the middle of 1950s credit against the security of commodities like foodgrains, groundnuts, cotton, jute or even shares, has been subject to selective controls. The credit to exports, small-scale industries and agriculture, has been liberalised. Also export credit has been made cheaper recently. Selective controls have thus been used to subserve larger economic objectives.

24. The controls on scheduled banks are exercised with great discretion. There are both informal and formal meetings of bankers with the Governor of the RBI. The Governor, through moral persuation also impresses upon banks the necessity of implementing a particular policy.

25. Another important function performed by the RBI is the administration of exchange control. The RBI itself does not directly regulate imports or exports. But it exercises supervision over the prescribed methods of payments for imports and the repatriation of proceeds of exports, besides other transactions which entail receipt or payment in foreign exchange.

26. The Bank has licensed a number of commercial banks to deal in foreign exchange. These authorised dealers are allowed to cover spot and forward exchange transactions at market rates. The authorised dealers are permitted to open letters of credit to make remittances in payment for imports provided the goods are covered by a valid import licence. The control on exports is designed to ensure that foreign exchange proceeds of exports are remitted to India and not retained abroad. The control is operated jointly with the customs authorities.

27. The authorised dealers have to submit to the RBI statements in the prescribed forms of foreign exchange dealings. These statements are scrutinised by the Exchange Control Department of the Bank. These statements also enable compilation of India's balance of payments data.

28. The Department of Research and Statistics of the RBI also collects and compiles information on different financial matters. Such information enables better understanding of the problems and, to a certain extent, helps formulation of proper policies at proper time.

29. The RBI Act itself makes it obligatory on the part of the Bank to publish returns about the financial position of the Issue Department and the Banking Department. Apart from these weekly statements, the RBI brings out a weekly statement of consolidated position of scheduled banks, RBI Bulletin (Monthly), and Annual Reports like the Report of Central Board of Directors, Report on Currency and Finance, Trends and Progress of Banking in India, Review of Cooperative Movement in India and statistical compilation like the Statistical Tables relating to Banks in India and Statistical Statements relating to the Cooperative Movement in India.

30. The RBI also under took some developmental and promotional activities in the field of agricultural credit through its Agricultural Credit Department. However the promotional and developmental activities were, in spite of the bank's interest in agricultural finance, very much limited. The total assistance given by the RBI to State Cooperative Banks under Section 17 of the Reserve Bank of India Act was of the order of only Rs. 2.14 crores even in 1949-50. The Bank primarily functioned as a Central Bank.

31. With nationalisation, the RBI was entrusted with additional developmental and promotional activities. This made the RBI responsible not only for the management of money but also for all kinds of credit short-term, medium-term and long-term agricultural and industrial as well as for diverse kind of guarantees.

32. Although cooperative societies had made some headway by 1950, cooperative credit was still an insignificant part of the credit available to the farmer. The funds came mostly from money lenders and were subject to very high rates of interest. The All India Rural Credit Survey estimated that in 1951-52 cooperative credit was only a little more than 3 per cent of the total borrowing of the cultivator. The bulk of the finance, viz., 70 per cent, came from the money lender and the trader.

33. In pursuance of the recommendations of the Informal Conference convened in February 1951 and the All-India Rural Credit Survey Report, the RBI now provides credit facilities to State Cooperative Banks and Central Land Mortgage Banks for a variety of uses and for different periods. The Reserve Bank does not finance agriculturists directly but provides assistance to State Cooperative Banks and Central Land Mortgage Banks. Under Section 17(2), the Reserve Bank provides assistance for seasonal agricultural operations, marketing of stocks, bonafide trade or commercial transactions, and general agricultural purposes like land reclamation, irrigation, purchase of livestock, machinery, etc. The loans given under section 17(2) are usually for short periods of less than 15 months. Loans from National Agricultural Credit (long-term operations) Fund are for long periods (not exceeding 20 years) and from National Agricultural Credit (Stabilisation) Fund for medium periods (15 months to 5 years).

34. The total assistance given by the Reserve Bank to State Cooperative Banks and Central Land Mortgage Banks was of the order of Rs. 355 crores in 1966-67 as compared to Rs. 2 crores in 1949-50. The bulk of the assistance viz., Rs. 334 crores or 95 per cent of the total assistance was for short periods. The RBI is restrained from giving larger medium and long term assistance because the risk to its viability as a Central Banking Institutions should be at the minimum.

35. To obviate this difficulty, the Agricultural Refinance Corporation was set up in July 1963 with the specific objective of providing medium and long term credit mainly by way of refinance to eligible institutions like the Central Land Mortgage Banks, the State Cooperative Banks or the Scheduled Banks.

36. The assistance actually provided by the Agricultural Refinance Corporation has not, however, benefited agriculture to any significant extent. The total withdrawals made upto the end of March 1967 were of the order of only Rs. 6.54 crores although the total sanction of refinance was of the order of Rs. 43.85 crores. The institutional arrangements for enabling agriculture to take advantage of the resources at the disposal of the Agricultural Refinance Corporation, which in themselves are meagre, do not seem to be appropriate and call for basic alterations.

37. The needs of agriculture are too vast and varied. Unless there is a proper central agency which is able to mobilise and make available adequate financial resources for short, medium and long-term uses, the potential growth of agriculture may not receive the much needed fillip.

38. The post-independence years also witnessed the emergence of a variety of institutions for financing industrial development. However, no coordinated and integrated plan for the establishment of these institutions was drawn up and followed. The development that took place was piece-meal and *ad hoc*, a deficiency which prevails even to this day.

39. The first institution viz., the Industrial Finance Corporation (IFC) was put up in 1948 with the active assistance of the RBI which subscribed 10 per cent of the initial capital. Subsequently, the RBI Act was amended to enable the RBI to give discounting facilities to the IFC.

40. The establishment of the IFC in 1948 was followed by a number of State Finance Corporations (SFCs) in different States. All the States, with the exception of Madras and Nagaland, have at present each a SFC established under the State Financial Corporation Act 1951. The Madras Industrial Investment Corporation established by the State Government in 1949 under the Indian Companies Act is functioning on the lines of a SFC. The credit requirements of industries in the Union Territories are met by the SFCs in the neighbouring States. The RBI has contributed 10—15 per cent to the capital of SFCs.

41. Two other important institutions with Reserve Bank patronage were set up in the last five years. The Industrial Development Bank of India (IDBI) came into existence in July 1964 as a wholly owned subsidiary of the RBI. The IDBI took over the Refinance Corporation which was earlier established by member banks to provide relending facilities against medium-term loans granted by these banks to medium-sized units in the private sector. The objective of the IDBI is to coordinate all credit facilities relating to long and medium-term financing of industries and, if necessary, adopt and enforce a system of priorities in promoting future industrial growth. The Reserve Bank of India has also constituted a Fund known as the National Industries Credit (Long-term Operations) Fund under Section 46(A) of the RBI Act to be used for making loans and advances to the IDBI for purchase of or subscription to stocks, shares, bonds, or debentures issued by the IFC or the SFCs.

42. The Unit Trust of India was set-up on February 1, 1964. Half of the initial capital was subscribed by the Reserve Bank of India. The general superintendence, direction and management of the affairs and business of the UTI are vested in a Board of Trustees appointed by the Reserve Bank of India.

43. Apart from its involvement in institutional finance, the RBI acts as a Guarantee Organisation with respect to guarantee schemes for small-scale industries. It also directs and manages the Deposit Insurance Corporation.

44. Thus, in the past 20 years a variety of institutions has been set up to meet medium and long-term requirements of industries. The total assistance given by these institutions increased from Rs. 2.1 crores in 1950-51 to Rs. 104.1 crores in 1966-67. This assistance is given by way of loans and credits, under-writing of and direct subscription to shares and debentures.

PART II

ASSESSMENT AND APPRAISAL

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45. In assessing the functioning of the RBI as the Central Bank of the country, we have to take into account the effectiveness with which it has been able to manage the monetary and credit system, to the best advantage of the national economy. More specifically, we have to consider:—

(i) how far the banking sector has been developed;

(ii) to what extent the management of money and credit has increased the mobility and turn over of the rupee and how far the stability of prices has been achieved;

(iii) whether wide and growing market for Government securities has been established;

(iv) how far the administration of exchange control has enabled effective check on external payments and receipts;

(v) what liaison has been developed with Central Banks in other countries and with foreign governments; particularly in the field of international financial movements;

(vi) how far statistics on various economic issues have been collected, computed, compiled, analysed, organised and widely disseminated to help better and timely understanding of economic phenomena and economic processes; and

(vii) in performing its function as the Central Bank how far the developmental functions have been a help or a hindrance?

46. The key functions of the Reserve Bank were defined by the 1934 Act in terms of regulation of currency issue, and keeping of of reserves with a view to securing monetary stability and to operate the currency and credit system of the country to its advantage. In the post-Keynesian revolution in economic thought and the growth of economic planning, it has been increasingly realised that credit is one of the key instruments of directing and channelling economic development and growth. While some measures in this direction have been taken by the RBI, it cannot be said that the Reserve Bank has utilised fully the potential of this instrument, especially in the short-term management of the economy.

47. To perform such a role, the Reserve Bank must continually suggest policies which will develop the full potential of the various sectors of the economy, institute appropriate measures to secure the flow of investments and credit and, in particular, identify the credit gaps in the economy which impede rapid economic growth.

48. As the central agency, the Reserve Bank is deeply concerned with the development of banking profession. There is need to

strengthen and augment professional expertise in the banking industry to tackle the priority sectors. The quality of managerial personnel will have to be raised and more specialisation and expertise in different sectors of the banking industry will have to be developed. Ultimately the success of the national banking and credit policies will depend upon the professional competence available within the banking industry. As the Central Bank, therefore, the Reserve Bank of India has vital stake in the development of a core of trained bankers and researchers in the field as well as the development of banking technology. The proposed National Institute of Bank Management whose governing Board is to be headed by the Governor of the RBI, is a good move in the right direction. It will provide considerable assistance but there will be many more emerging areas in banking policy and practices on which the RBI will have to suggest further measures.

49. Such an elaboration of the role of the Reserve Bank in turn has many implications for its internal organisation and set-up. So long as the long term financial institutions like IDBI, ARC and the Agriculture Credit Department are a part of the RBI, the capacity of the Reserve Bank to critically examine their areas of operation, pattern of investments and emerging credit gaps is limited. At the same time, these agencies too get unnecessarily circumscribed by the policies and personality of the RBI.

50. In so far as credit planning is concerned, while the National Credit Council is expected to perform this role, the Secretariat of the Council is the Reserve Bank of India. Unless the RBI is suitably equipped, the capacity of the National Credit Council to perform such a role would be hampered. Indeed the quality of advice rendered by the National Credit Council will depend on the type of secretariat it is served by.

51. In many developed countries, the management of money, credit policies, growth of banking on healthy lines, tapping of the resources of the vast middle class in urban and rural areas and inculcating banking habits among them, have been much more successfully done when the Central Bank is in a position to give more concentrated attention to these functions. The popularisation of gilt-edged securities and Bond Papers and tapping of rural resources, debt management etc., have to be done in a more systematic and dynamic manner than attempted so far by the RBI.

52 Banks are finding it difficult to reduce lending rates in spite of cuts in the deposit rates because operational costs are too high. These aspects have to be carefully looked into. Rural banking has to be vigorously promoted an aspect which is now receiving very welcome attention of the RBI at the direction of Government.

53. As a Banker to Government, the RBI has achieved only limited success in creating a proper market for Government securities. As such, Government cannot borrow on an adequate scale especially from the middle classes. Consequently, the RBI and scheduled banks have to take up a large part of the market loans. About 35.7 per cent of the Central Government securities are held by the RBI on its own account. Apart from subscriptions from institutional investors the real tapping of resources by making

gilt-edged securities popular among middle classes in rural and urban areas has not taken place. The process of issue of securities and payment of interest to the security holders is too complicated even today to attract the middle class investors. The yield rates and the issue prices have to be looked into to make them attractive in comparison with other investments. Also the nature and varieties of scrips may have to be increased to attract short-term investments in new series of scrips and bond papers of short term maturity.

54. As a banker to scheduled bankers, the assistance provided by the RBI has not been very significant. At the peak of the busy season in March 1966 the borrowings of scheduled banks from the RBI were about Rs. 300 crores, less than 8 per cent of their aggregate deposits. The credit policies—selective as well as general—adopted by the RBI have not had adequate impact on the price situation even though the RBI has been very persistent on the application of these measures and has been taking numerous measures from time to time. The banking facilities are confined primarily to urban areas. Even today the number of unbanked towns is quite large. The number of account holders is also small. For a population of 520 million the number of accounts at the end of March 1967 was only *one* million.

55. In recent years, the price situation has been far from satisfactory. In the five years ending March, 1968, prices rose by 58 per cent. The commodity prices, both of agricultural and manufactured goods, have shown a continuous upward trend which has reached almost an alarming proportion in the last three or four years. Of course, the Central Bank cannot be held responsible for this price inflation and cost inflation. But a more vigilant and comprehensively laid out programme of price discipline and price stabilisation could be and should be guided by the RBI as the Central Banker of the nation. The RBI should make it one of its major functions to study and advise Government on working out policies and establishing institutional measures like the buffer stock operations of essential commodities, minimum support prices and maximum release prices, to keep watch on the inter-related price movements of essential commodities and manufactured goods, to impose selective credit policies, undertake open market operations etc. which may help Government to bring about price discipline, price stabilisation and cost consciousness in the national economy. It is these tasks to which we give greater importance as far as the main functions of the RBI are concerned.

56. In the management of foreign exchange, the deficiencies and weaknesses are far more pronounced. At no time either the statistical compilation or analysis was fully and immediately available to the Central Bank or the public at large as far as the actual receipts and payments of foreign exchange were concerned. In the modern economy uptodate information about the actual position of payments and receipts of foreign currencies is very vital. Immediate measures and steps can only be taken if the balance of payments position is under correct and critical assessment from week to week. In this task the RBI needs to be considerably strengthened.

57. The administration of exchange control leaves many loopholes. The RBI does not have uptodate adequate information about actual foreign exchange committed to and utilised for different major groups of import and export products from week to week or within a short period of time so as to be useful for taking any corrective or remedial steps. The maintenance of records is neither systematic nor satisfactory; the information contained in the CR Returns sent by various authorised dealers is not utilized fully.

58. In the long run, it is also possible for a Central Bank to tap foreign resources from several international financial agencies. This may not be immediately practicable while large scale government to government loans are being received. All the modern Central Banks have, however, successfully raised and received large foreign currency loans by this device and for this task, the RBI should pay greater attention so that in future years this can be good source of foreign exchange accommodation.

59. In the mangement of foreign exchange the codification of importers and exporters—at least codification of major importers and exporters—is long over due. Presently the importers and exporters are utilising the service of numerous authorised exchange banks and authorised exchange dealers making a correct statistical assessment almost impossible. It is, therefore, most important that a thorough examination is made of the working of authorised foreign exchange banks and authorised foreign exchange dealers to rationalise the present pattern.

60. That the RBI came to perform promotional and developmental functions in addition to its functions as a Central Bank was a mere historical accident. Some may even argue that put it forward as a novel, unique and useful experiment in a developing economy, even though there is hardly any parallel of it either in a developing country or a developed country or in a centrally planned economy. Of course, we do not take this—absence of a similar example—by itself as an argument against continuing the present functions and working of the RBI. However, after examining the pros and cons of all the aspects we are of the clear view that for the RBI to continue with these functions would be denying it the privileges of acting as an effective Central Bank and diluting the prime objective for which it was set up. The needs of the economy are growing and a single central organisation cannot look after all the points and the requirements of all sectors.

61. The promotional and developmental activities of the RBI do not go well with its role as a Central Bank. Greater mobilisation and better utilisation of resources are possible only when there are specialised institutions using more imaginative and effective methods of mobilisation of sectoral resources by closer and more coordinated efforts and by better catering and personalised service to the needs of the different sectors through closer contacts and local knowledge.

62. It will, therefore, be best if the RBI concentrates its main operations to those of a Central Bank, for which such an institution operates in every country of the world, and shed its developmental functions, which do not properly belong to it. If as a Central Bank

the RBI is to discharge effectively its main functions of management of money, development and regulation of banking and credit policies and administration of foreign exchange control, it should not be bothered with the developmental and promotional functions. These should be entrusted to separate institutions altogether.

63. Before Independence, the British Government was not interested in development of the country and hence most of the developmental work, which had to be initiated by it willy-nilly, was loaded on the RBI. It failed to put up any well laid out institutional framework. The RBI which began as a Central Bank was thus periodically burdened with miscellaneous tasks of financing the peripheral development work. Thus the functions of agricultural and cooperative financing came to be entrusted to the RBI instead of being assigned to separate institutions as in other countries.

64. It is true that an important function of the RBI, as of Central Banks in other countries, has to be to watch, coordinate and supervise all developmental organisations. But when the RBI manages by itself all the functions, the advantage or supervision, inspection, detached and objective guidance suffers grievously. The superior, the guide and the executive become amalgamated into one. This is an unhealthy feature and should be avoided.

65. The RBI is an apex and premier financial body of the nation. Its prestige and image has to be kept high. Therefore, Parliamentary or public criticism has to be eschewed. In all countries the Central Bank generally enjoys a privileged position, as it should, because the financial prestige in the country and in the international field has to remain above criticism and controversies. The RBI should be kept out of public criticism, and, therefore, as far as possible such functions which have to directly cater to a large number of beneficiaries should remain outside the RBI. Once such a Central Bank undertakes vast developmental functions, it also shelters such developmental bodies from public criticism, dialogues and discussions. Indeed, the developmental institutions grow with gaze, public probes and public debates. Developmental function can benefit much from various interests being heard and represented. This is not possible when the RBI itself is the developmental organisation. So it is best that the institutional pattern of development of Agriculture, Cooperatives, Industries, Export & Import, small-scale industries etc. are constituted on their own so that they would have the benefit and response of constructive public criticism and opinions.

66. The ownership of all the development organisations must be so dispersed that the majority shares remain in the hands of the Government and Government organisations. While the activities of these institutions reflect Government policies, they can also derive advantage from other participating interests.

67. The Board of Directors of the developmental organisations should consist mainly of the representatives of interests it seeks to serve. Presently the RBI Board and its nominees man all the Boards of Directors. Once the developmental organisations are constituted independently, they will have the benefit of the experience and expertise of representatives and experts on the boards who will be able to promote and implement the main goals of the respective organisations.

68. In Part IV of this report, we have recommended the establishment of separate Developmental Institutions such as the National Agricultural and Cooperative Bank (NACB), the Central Small Industries Bank (CSIB) and the Export Bank of India (EBI) etc. The National Agricultural and Cooperative Bank should have a large number of representatives of the agriculturists and cooperative movement so that unlike the present advisory bodies under the RBI, the representative Boards will be able to give the correct bias. Likewise the Central Small Industries Bank or the Industrial Development Bank of India (after separation from RBI) should have respectively on their Boards the representatives and experts of small scale industries (on the CSIB) and the representatives and experts of medium and large-scale industries (on the IDBI). Intense and large representation of true interests of the people, the particular institution seeks to serve, should have much effective voice in its directions, policy making, implementation and management. Once these institutions are separated from the RBI, this vital benefit will follow automatically.

69. For the reason stated above, we recommended that the RBI's main function should be the management of money, management of public debt, policy making and development of banking, management of foreign exchange, guidance and control of credit policies for effective price discipline and scientific and systematic data collection and statistical analysis of the different vital sectors of the country's economy. Once the extra load is shed, the RBI with the expert leadership, that it already possesses, will be great help to and the prime mover of country's economic development.

70. The banking industry needs great fillip. Only about 15 per cent of the National Income is at present banked. Non-banked Income remains slow and erratic in its circulation with unhealthy consequences. The RBI should concentrate on expanding and strengthening the country's banking sector so that credit as a vehicle of economic growth takes its vital and powerful place in the national economy. The more the money flows from rural and urban areas into the banks the faster will be the velocity of money turnover and lower the cost of credit.

71. Likewise the management of foreign exchange is not very satisfactory. The reorganisation and streamlining of authorised foreign exchange dealers, codifications of importers and exporters, speedy computation of receipts and payments (visible and invisible) of foreign exchange has become absolutely essential. All this can be done by the RBI with great efficiency through use of modern techniques. Under-invoicing and over-invoicing which is reported to be in vogue can be effectively scrutinised and proper guiding principles and steps devised and enforced by a vigilant and expert RBI, only if it concentrates on these main functions as the nation's Central Bank.

PART III

CENTRAL BANKS IN OTHER COUNTRIES

PART III

CENTRAL BANKS IN OTHER COUNTRIES

72. We may now examine the credit system in other countries, viz., France, Japan, U.K., U.S.A., U.S.S.R. and Hungary.

73. The credit system in France differs in many essential respects from that in India. Banks in France are either deposit banks or investment banks. The former specialise in short-term and the latter in medium-term credit. The four biggest of the national banks were taken over by the State at the end of World War II. There are also regional banks and local banks. Apart from these, there are specialised credit institutions. the principal among which is Caisse Central de Depots et Consignations. The Caisse's resources consist of deposit of funds by savings banks, social security, pensions, etc., and are used to finance operations of the State, Local Authorities and other socialised institutions. The financing of industry is done primarily through Credit National and of agriculture through Credit Agricole. The Bank of France, apart from management of money, engages itself in different types of rediscounting operations. About 32% of the national income is banked in France. The Bank of France, which is the Central Bank, has no direct developmental functions.

74. The financial system in Japan consists of the Bank of Japan, ordinary banks, specialised Government institutions, mutual loans companies, Credit Co-operative Associations, Agricultural Credit Co-operatives, Trust Fund Bureau and Postal Savings. The Bank of Japan carries on the normal functions of a Central Bank. It has, however, wider powers "for the maintenance and fostering of the credit system" and "for the attainment of the object of the Bank". The credit operations of ordinary banks are mainly short-term. Only about 10 per cent of the outstanding aggregate credit finances purchases, maintenance or repair of plant and equipment. Japan is perhaps the most banking minded country in the world. About 71% of the national income of Japan is banked.

75. Japan has a group of important Government and semi-Government institutions for financing industrial development. These include the Industrial Development Bank, Central Bank for Commercial and Industrial Co-operatives, Export-Import Bank of Japan and the Japan Development Bank. The Central institutions in the agricultural credit system is the Hypothec Bank of Japan and in the field of agricultural co-operatives the Central Co-operative Bank for Agriculture and Forestry. Both are under the direct control of Government.

76. The Bank of England is perhaps the oldest Central Bank. It enjoys the highest reputation. The Chairman of the Bank of England enjoys a very high status in U.K. Banking has also developed very well in U.K. About 33% of her national income is banked. Most of the payments are done by cheques, drafts etc. Bank of England does

not deal directly with any long term or medium term credits for which in due course separate development organisations can come up in the U.K.

77. The Agricultural Mortgage Corporation Ltd., was set up in 1928. Apart from loans from the Government the Corporation raises funds by issue of debentures. The important finance companies were set up with official support after World War II. The Industrial and Commercial Finance Corporation was established in 1945 to help smaller companies. The capital of ICFC is subscribed by commercial banks of England and Scotland. The Bank of England had made only a token subscription. The Finance Corporation for Industry was also established in 1945 with the object of providing medium and long-term capital for reorganisation and re-equipment of major industries. The capital is subscribed mainly by Insurance and Investment Trust Undertakings. The FCI has an arrangement for borrowing from commercial banks. Apart from these major institutions there are other specialised institutions like the National Film Finance Corporation, Export Credit Guarantee Department, etc.

78. The Commercial Banks which are large in number in the USA finance a variety of transactions, both current and capital. They give short term loans (mainly to medium and small concerns), secure business loans for financing, receivables and inventories, give instalment equipment loans, short term agricultural loans, loans to finance securities, real estate loans and consumer loans. Different consortia of Commercial Banks give long term advances to industries, underwrite their scrips and guarantee long term loans for development to industrial units. The business of commercial banks in the U.S. is much diversified and intense in operation. The U.S. "Federal Reserve System" which is the counter-part of the Reserve Bank of India concentrates on credit policies, clearing functions and the financing. It does not deal with any of the development functions directly. One of it's important functions is to control and supervise the foreign exchange and foreign currency operations and supervise the foreign investments. The entire monetary and credit system of the USA is watched and supervised by the Federal Reserve System. The Federal Reserve System does not get directly involved into direct developmental lending or loans. The Governor of the Federal Reserve System is appointed by the President of the United States and the Governor of the Federal Reserve System enjoys the status of the Secretary of State for Treasury.

79. In the U.S.A., the Farm Credit Administration has been established under a Statute and it controls the activities of Federal Land Banks, Farm Production Credit Corporations, Federal Intermediate Credit Banks and Banks for Co-operatives. The Governor of Farm Credit Administration is nominated by the President of the U.S. Housing and Home Finance agency established by the Federal Government specialised in assisting and developing housing credit institutions.

80. The main work and functions of the Federal Reserve System in the U.S.A. are to control monetary system, money supply, currency reserves, foreign exchange control, foreign exchange regulation and regulations for foreign investments, besides refinancing and clearing

functions. Commercial Banking and other forms of Banking are highly developed and widely dispersed in the U.S.A. of their colossal national income, about 47% is banked.

81. The credit system in the U.S.S.R. is closely integrated with the national Plans. The objective is to secure "control by the Rouble." The banking system consists of the State Bank of U.S.S.R. (Gosbank); Foreign Trade Bank of the U.S.S.R. (Vneshtogbank), Special Banks for long-term development and investment and a network of savings banks.

82. The Central Credit Institution is the Gosbank. Apart from carrying on the functions of a Central Bank it also combines in itself the normal functions of commercial Banks in other countries. The Gosbank—

(i) gives short-term credit,

(ii) mobilises free monetary resources of enterprises, establishments and organisations,

(iii) provides a clearing system,

(iv) keeps accounts of the State,

(v) regulates monetary circulation,

(vi) deals with foreign transactions,

(vii) exercises control over correct utilisation of credit by the enterprises.

83. The Foreign Trade Bank of the USSR was established in 1924. It is responsible for promoting the development of foreign trade. Along with the Gosbank it undertakes foreign receipts and payments, handles operations connected with cash and accounting services for foreign embassies and missions in the USSR, provides currency services for foreigners visiting the USSR and Soviet citizens travelling abroad.

84. The long-term investment of funds is undertaken by Special Banks. Prior to 1957, there were four such banks viz., the Industrial Bank (Prombank), the Agricultural Bank (Sel'Khozbank), the Trading Bank (Torgbank) and the Central Bank for financing municipal economy and housing construction (Tsekombank). In 1957, the Torgbank (Trading Bank) was wound up and its functions were taken over by Sel'khozbank (Agricultural Bank) and Tsekombank. Prombank (Industrial Bank) finances the capital investments of State enterprises and construction organisation in industries, transport and communications and handles short-term credit of contract building organisations in these branches of the national economy. *Sel'khozbank* finances capital investment for State enterprises and agricultural construction organisations, agricultural procurement organisations and consumer cooperatives. It also handles short-term crediting of agricultural contract building organisations, long-term crediting of *kilhozes* and producers' cooperatives and crediting for private house building in rural areas. *Tsekombank* finances housing, municipal and cultural construction and capital investment in State trading. It also gives, short-term credit to contract building organisations engaged in trade, housing and municipal and cultural construction and for individual house building in towns and workers' settlements.

85. The Savings Banks mobilise the savings of the individuals. These Banks accept various types of deposits on current, time, conditional and lottery accounts. The deposits of the Savings Bank are channelled into Gosbank and form a part of budgetary revenues. The Savings Banks provide other banking services also. The Savings Banks undertake sale of State Bonds.

86. The Credit system in Hungary is similar to that in the USSR. It consists of the National Bank of Hungary which is their Central Bank like the *Gosbank* of the USSR. Other specialised banks include the Hungarian Investment Bank, the Hungarian Foreign Trading Bank Limited, the National Savings Bank and the Mutual Benefit Savings Bank. The National Bank of Hungary undertakes the normal functions of a Central Bank. It regulates the quantity of banks notes, administers gold and foreign exchange reserves and acts as a banker to Government. Apart from these normal functions of Central Bank, the National Bank of Hungary accepts deposits of unutilised financial resources of the State organisations, enterprises and cooperatives, maintains their banking accounts and makes payments on their behalf. It also gives direct short-term credit to enterprises and cooperatives.

87. The Hungarian Investment Bank is an independent organisation. It grants credit to building enterprises, handles their financial turnover, finances investment out of the investment funds allotted for this purpose in the State budgets, and gives medium-term credits to enterprises for the implementation of speedily refundable investments.

88. The Hungarian Foreign Trading Bank Limited undertakes foreign exchange transactions in cooperation with the National Bank of Hungary. The shareholders of the Bank are the Hungarian Foreign Trading Companies. The Minister of Finance is the Superintending Authority.

89. The National Savings Bank is the Bank of private individuals and performs the normal banking functions of accepting deposits, granting credit, etc. and also organises lotteries. The Mutual Benefit Savings Bank operates under the control of the National Savings Bank.

90. In the light of the above, we may now consider the pattern of reorganisation of the RBI. This has been outlined in Part IV and Part V.

PART IV

REORGANISATION OF THE RESERVE BANK OF INDIA

Conclusions and Recommendations

PART IV

REORGANISATION OF THE RESERVE BANK OF INDIA

CONCLUSIONS AND RECOMMENDATIONS

91. The brief review outlined in Part III of the credit systems in other countries brings out that the development of the economy is considerably facilitated if there are specialised institutions providing finance for different sectors. In that way, the needs of small and large industries or of agriculture are assessed more systematically and are met more fully. It is for this reason that the functions of the RBI as a promotional and developmental institution, on the one hand, and as a Central Bank, on the other, should not remain combined together. To streamline the credit mechanism, it would be desirable to unburden the Reserve Bank of the developmental and promotional activities to enable it to specialise in its functions as a Central Bank. In our view, the RBI has been over-burdened with developmental functions which make its main responsibilities as a Central Bank look secondary.

92. The overall credit system should be reorganised in the following manner—

A.1 The RBI to specialise in the management of money credit and foreign exchange and otherwise act as a Central Bank.

A.2 The State Bank of India, the 14 nationalised banks and other commercial banks to provide short-term credit for all purposes.

A.3 Foreign Exchange Administration and Control to be with the RBI which will be reorganised on a more modern and systematic basis.

A.4 Raising and tapping of savings and credit resources and development of Banking at a much accelerated pace by the RBI.

A.5 General supervision and guidance by the RBI of price discipline and price stabilisation through credit and other measures.

A.6 Data Bank (for all important internal statistics and trade statistics) to process all statistical information.

A.7 Banking Coordination Committee to coordinate the functions of major financial institutions with the Governor of the RBI as its Chairman.

All the above functions will be the direct responsibility and charge of the RBI. The following will be separate developmental agencies—

(1) National Agricultural and Cooperative Bank to supply credit to agricultural and Cooperative Sectors.

(2) IDBI and SFCs to finance organised industries.

(3) UTI to invest in shares, debentures etc. of companies.

(4) Central Small Industries Bank along with State Small Industries Banks to cater to the needs of small scale sector.

(5) Export Bank of India.

(6) In addition to each financial institution providing guarantees and guarantee funds within their own organisation, if after a few years, it is considered useful, a National Credit Guarantee Fund may be constituted as a Central Credit Guarantees Organisation, mainly for purposes of counter-guarantees.

93. The RBI should concentrate its activities to six main functions (including those covered under A.1 to A.7 in para 92 above), namely—

(A) Management of Money.

(B) Banker to Government.

(C) Banker to State Bank, nationalised banks and other commercial banks.

(D) Discounting bills of other financial institutions.

(E) Administration of exchange control.

(F) Overall supervisions and control over all credit and financing agencies.

The RBI should continue to keep a watch on the working of the developmental institutions. The RBI will be represented on the Board of Directors of these separate developmental organisations.

Money and Credit

94. The RBI should use its powers effectively to regulate money and short-term credit. For this purpose the various instruments of control which have been mentioned in Part I should be suitably made use of. The distribution of credit among various sectors of the economy will be made in accordance with the directives of the National Credit Council.

95. The market for gilt-edged securities, which has become too narrow and is restricted to only the institutional investors like the LIC, Provident Funds and Scheduled Banks, should be enlarged to tap the resources, not only from urban, but also from rural areas. It may be possible to use the services of cooperative banks for this purpose.

96. The open market operations policy of the RBI needs considerable toning up. If the RBI is able to develop successfully a market for gilt-edged securities and unburden its own holdings of Government debt, it will be possible for the RBI to have greater control over the management of money and the structure of interest rates. This is necessary to regulate the general liquidity in the economy and the structure of interest rates and thereby promote equitable distribution of financial resources between different sectors.

97. The development of banking generally has not been commensurate with the financial needs of the economy. The proportion

of deposits to the national income in India is extremely small as compared to that in other countries like Japan and the U.S.A. No doubt, the State Bank has been more or less able to fulfil its branch expansion programmes. But, an all out drive with the assistance and under the dynamic patronage of the RBI has to be made to serve moffusil and rural areas which at present have little banking facilities. This effort will be considerably eased with the nationalisation of 14 major commercial banks.

Foreign Exchange Control

98. At present, foreign exchange dealings are carried out by various foreign exchange dealers. In the short time at our disposal, it was not possible to investigate fully the intricacies of the present arrangement. But it is felt that there is a great need to streamline the system for preventing any possible misuse. It is generally known that undesirable practices, like under-invoicing in the case of exports or over-invoicing in the case of imports, are prevalent. It is, therefore, suggested that the system of authorised dealers should be looked into by a three-man high powered committee. In the mean time, it may be perhaps advisable to rationalise the pattern by some regulation on the bigger importers and exporters to deal only through a few selected authorised dealers at any centre so that a dependable check on their remittances and receipt of foreign exchange could be initiated. Gradually the bigger importers and exporters could be given code numbers which should be quoted in all their transactions of foreign exchange. This would help keep track of any particular party.

99. The functions of the Customs and the RBI as regards imports and exports, under-invoicing and over-invoicing, the valuation and follow up action on GR forms and shipping documents, L.C's and payment documents are not very clearly demarcated resulting in lack of adequate coordination and control. The suggested high powered committee should, therefore, examine the complementary nature of the functions of Customs and the RBI as far as foreign trade matters are concerned and indicate clear demarcations of functions with such coordination as may be useful and necessary.

100. The RBI is not able to make use of the wealth of information contained in the GR and other returns submitted by the various foreign exchange dealers. The work regarding the computerised compilation of this information has been hampered due to labour resistance, to some extent. It may, therefore, be considered whether the department of data and statistics be separated from the operations department and the work entrusted to a new Data bank to be formed as a separate company jointly owned by the RBI, the State Bank of India and the nationalised banks. The main objective behind our suggestion is to computerise and tabulate the information contained in GR returns and other statements. This would make it possible to have complete knowledge and up-to-date position about foreign exchange earned or spent by different parties or from different destinations or different commodities, or different kinds of invisibles etc. This information can be used to administer foreign exchange control more efficiently and prevent any possible abuse. Also data and statistics regarding deposits from different classes of investors, rural and urban

areas and advances to different categories of borrowers by different banks could be had on tap.

101. This Data Bank of the RBI, the State Bank of India and the nationalised banks should publish large number of useful small pamphlets containing analysis and compilation of useful credit data, price movements, and trade statistics for the use of industries and business people. Such pamphlets containing data, statistics, analysis, assessment and reviews of the national economy will be most useful to all concerned.

102. Although the first task of the Data Bank will be to computerise all the information contained in GR returns submitted by various foreign exchange dealers, the Bank can be used to process a variety of other information also. There is considerable resistance from the trade unions to such a move. These difficulties can be overcome if, as suggested earlier, the Data Bank is made a separate institution altogether having the sole objective of processing information by means of computers. This new company will be a fresh employer and will provide additional employment and as such no resistance from trade unions would arise on account of any retrenchment or rationalisation. In due course, to avoid natural wastage, the personnel in the operational statistical sections of the RBI could be reduced. Necessary trained labour for the Data Bank can no doubt be recruited from the existing statistics and operations departments of the RBI. The existing statistical wing can also simultaneously function for the time being. But, gradually, as greater use is made of computers, the present Statistical Department using manual labour will continuously shrink in size and can ultimately be scrapped. The scope of operations department statistics should be different from the central statistics of the Data Bank.

103. The computerised information will make it possible to know at any point of time the foreign payments received or foreign exchange remitted and utilised by different parties, for different purposes and for different destinations. The informations will also help to have a check on the transactions of different parties and reduce any possible misuse of foreign exchange. The tabulation of visible and invisible payments and receipts will be duly made.

104. The scope of the Data Bank is no doubt vast. The Data Bank is not really an institution by itself. It is only a department using mainly computers for the processing of Data. It is given a status of an institution mainly to facilitate organisation. The RBI and the State Bank of India, we know, have computers and if they can undertake quick compilation of analytical data on deposits, advances, savings, foreign exchange receipts and payments, foreign trade statistics, then of course no separate jointly owned Data Bank would be necessary. If possible, while it may be impossible to computerise DGCI, Calcutta Office due to extreme labour resistance, the RBI data bank (or data department) in Bombay should arrange quick and analytical compilation of foreign trade statistics by computers.

105. As a premier organisation concerned with the finances of the economy the RBI is continuously engaged in economic research. While some very good work on these lines is done at present, the scope

and the dimensions of work are extremely limited. There are no systematic publications of the analysis made of major economic issues. In most foreign countries research is one of the major responsibilities of central banking institutions.

106. The Economic Adviser's Department of the RBI is constituted of several divisions specialised in planning, wages, income and pricing policy, international finance and trade, monetary economics, rural economics, and banking. But the output of these divisions for public use, education and information has been extremely meagre. Occasional studies have been brought out mainly in the RBI Bulletins. The Research Wing, therefore, requires considerable strengthening.

107. The RBI with the large statistical resources at its disposal should engage itself more intensively and extensively in a comprehensive programme of publication of series of pamphlets on the analysis, publicising achievements in different fields of the economy as assessed by it, evaluation and remedial suggestions on current economic problems. This will help better understanding of economic functioning and help devise suitable policies for making the economy more healthy or make it grow rapidly. Also Universities and Schools of Economics and Commerce should be closely associated with the Research Department and its publication Wing.

Relations between the RBI and these Developmental Financial Institutions

108. The relationship between these developmental financial institutions and the RBI would be more or less of the same nature as that between the commercial banks and the RBI. The RBI exercises control over the scheduled banks in three ways—

(1) banks have to conform to the directives issued by the RBI;

(2) banks furnish information about their assets and liabilities; and

(3) banks are inspected by the RBI.

109. The policies of the developmental financial institutions will be regulated by their respective boards where the RBI will be represented. These policies will be in line with the policy directions of the Central Government and the RBI from time to time. The RBI will inspect the working and functioning of these financial institutions so that they operate on sound commercial basis. For this reason, these institutions will have to submit, like the scheduled banks, regular information about their assets and liabilities and other details required under the respective statutes by the RBI. The RBI will inspect the accounts of these institutions to see that correct procedures are followed.

110. All these provisions will have to be incorporated in the respective statutes or amending Acts in terms of which the developmental financial institutions will be set up and also by amending, wherever necessary, the Reserve Bank of India Act 1934. Broadly, as mentioned before, the relationship of these institutions with the Reserve Bank will be on lines similar to what exists between the commercial banks and the Reserve Bank.

PART V

RE-ORGANISATION OF DEVELOPMENTAL INSTITUTIONS
Conclusions and Recommendations

PART V

RE-ORGANISATION OF DEVELOPMENTAL INSTITUTIONS

CONCLUSIONS AND RECOMMENDATIONS

111. The development of the different sectors of the economy like agriculture, large and medium industries, small industries and exports is facilitated if their needs are looked after by specialised institutions. In almost all other countries such specialised developmental institutions have been set up, mainly with the initiative of Government and have proved quite successful. We have, therefore, suggested that we should have a National Agricultural Cooperative Bank (NACB) to look after the financial needs of agriculture; an independent Industrial Development Bank of India (IDBI) with SFCs as subsidiaries for financing medium and large industries; an independent Unit Trust of India with four or five zonal organisations. Central Small Industries Bank (CSIB) to finance small industries and Export Bank of India (EBI) to provide credit for exports.

National Agricultural and Cooperative Bank

112. To regulate, direct and control the activities of all institutions providing short, medium and long-term finances to agriculture, a separate institution called National Agricultural and Cooperative Bank should be established by an Act of Parliament. The Agricultural Credit Department of the RBI, together with the National Agricultural Credit (Stabilisation) Fund and National Agricultural Credit (Long-term Operations) Fund, and the assets and functions of the Agricultural Refinance Corporation should be taken over by the NACB. The Agricultural Refinance Corporation should be wound up.

113. The NACB should be the apex institution in the field of cooperative and agricultural financing. Its main functions should be—

(i) to grant short-term and medium-term loans (including refinance) to State Cooperative banks, nationalised banks, other commercial banks for agricultural and allied operations such as animal husbandry, dairy farming, pisciculture and poultry farming;

(ii) to grant long-term loans (including refinance) to nationalised banks and other commercial banks and Central land mortgage banks for specific agricultural and area development programmes (more or less on the same lines as done by present Agricultural Refinance Corporation);

(iii) to contribute to ordinary and special debentures floated by Central land mortgage banks;

(iv) to provide guarantees to the lending banks, to the State Cooperative Agricultural Banks, to the State Agricultural Credit Cooperatives and other eligible institutions. An appropriate guarantee fund should be created by the NACB within the Organisation.

(v) to undertake such function for purposes and development of agriculture as may be specifically directed by the Central Government.

114. Having regard to the proposed functions which we are envisaging for the new bank, it will not be necessary to retain the Agricultural Refinance Corporation and the Agricultural Credit Department of the Reserve Bank in their present form. The assets and liabilities and the functions of the Agricultural Refinance Corporation will be taken over by the NACB. As for the Agricultural Credit Department, the refinancing of short-term loans given by the State Cooperative bank for financing seasonal agricultural operations or the marketing of crops will be taken over by the new institution, and the Agricultural Credit Department need confine itself only to the new responsibilities which have devolved on it on account of the extension of the Banking Regulation Act to the Cooperative Banks. In other words, its function should be primarily in the field of licensing and inspection and general policy matters relating to Cooperative Banks more or less on the same lines as is done by the Department of Banking Operations and Development in respect of commercial banks.

115. The initial capital of the National Agricultural Cooperative Bank will have to be of the order of, say, Rs. 150 crores, Rs. 60 crores subscribed by the Central Government, Rs. 60 crores by Reserve Bank, State Cooperative Banks, Central and Land Mortgage Banks, the State Bank and nationalised banks, Rs. 30 crores.

116. We do not think there should be any difficulty in the contribution of the share capital by the Reserve Bank. The Reserve Bank at present maintains two funds namely Agricultural Credit (long-term operations) Fund, and National Agricultural Credit (Stabilisation) Fund. The corpus of long-term operations fund is Rs. 131 crores out of which the balance available as on 14-6-1968 was Rs. 79 crores. A part of the fund is utilised for giving loans and advances to State Governments to enable them to subscribe to the share capital of cooperative institutions. The Reserve Bank may continue to make such advances to the State Governments and we do not disturb this arrangement for the time being. The Reserve Bank may, therefore, keep a part of the fund for this purpose and may transfer the bulk of the fund to the NACB against the share capital that will be allotted to it. We do not think that there should be any difficulty in tansferring Rs. 60 crores out of this fund for the share capital of NACB.

117. We have also considered the question whether the National Agricultural Credit (Stabilisation) Fund should be transferred to the NACB. The corpus of the fund is Rs. 25 crores out of which the balance available as on 14-6-1968 is Rs. 18.70 crores. This fund is utilised for advancing medium-term loans to State cooperatives to enable them to convert their overdue short-term loans which have accumulated owing to drought, famine and other natural calamities. When the new bank is set up, it will not be necessary to maintain any such fund in the Reserve Bank and the fund may be abolished and merged in the general resources of the Reserve Bank.

118. As for the contribution of share capital by the Central Government, we understand that there is a proposal to set up a Fertilizer Credit and Guarantee Corporation. One of the objects of the Corporation would be to refinance loans given by cooperative and commercial banks for the stocking and distribution of fertilizers. Since this function is proposed to be taken over by the NACB, the Central Government could consider transferring the amount (which we understand would be of the order of Rs. 40 crores) earmarked for the proposed Corporation to the new institution. The balance can come out of the increased surplus that would accrue to the Central bank from the Reserve Bank because the Reserve Bank would no longer be required to appropriate about Rs. 17/18 crores annually for the two funds.

119. The National Agricultural and Cooperative Bank will be authorised to issue debentures for raising resources and this could be subscribed by the Reserve Bank, LIC, commercial banks and other financial institutions. The NACB should also have access to the Reserve Bank as a central banking institution and have the facility of discounting bills and promissory notes with the Reserve Bank. The ratio of paid-up capital and reserves to borrowing should not exceed 1:10.

120. The Board of Directors of the National Agricultural and Cooperative Bank will be constituted by the Central Government. The composition of the Board will be such as would adequately represent the Reserve Bank, State Cooperative Banks, State Bank, nationalised banks and Farmers Organisations apart, of course, from the Central Government.

121. The provision of credit to agriculture will eventually have to come from the cooperatives. However, at present, wherever the cooperative system is not strong enough, credit should be channelled through as many available institutions as possible including the commercial banks. The National Agricultural and Cooperative Bank would, however, have to take some initiative in fostering the growth of cooperatives, and for this purpose, provide adequate training facilities.

122. We understand that Government are thinking of setting up State Agricultural Credit Corporations in different regions of States where apex cooperative banks are not functioning well. Such corporations will have a useful role in the provision of agricultural finance. In the scheme that is envisaged here, the State Agricultural Credit Corporations can be dovetailed in the proposed organisation for the purpose of distribution of short and medium-term finance. We also understand that some of the State Governments have, at the instance of the Ministry of Agriculture, decided to set up Agricultural Development Corporations which will combine both long and medium-term credit and also provide ancillary services relating to agricultural production which are generally useful to farmers. These Agricultural Development Corporations should also be fitted in the scheme of financing by the National Agricultural and Cooperative Bank.

Industrial Development Bank of India

123. Credit to medium and large industries will be given by the IDBI as an independent central organisation with SFCs as subsidiaries. The IFC will be merged into the IDBI and the assets and the functions of the IFC will be taken over by the IDBI. The National Industrial Credit (long-term operations) Fund of the RBI will also be taken over by the IDBI. Suitable amendment to or re-enactment of the Act will have to be made.

124. The object of the IDBI (together with the SFCs) will be—

(i) to give medium and long-term loans to medium and large industries;

(ii) to under-write and subscribe to shares and debentures of industrial concerns;

(iii) to extend guarantees to Indian and foreign parties, i.e., to medium and large industries and to create a guarantee fund for that purpose within the IDBI;

(iv) to give long term loans to Industries for modernization on the lines of the National Industrial Development Corporations; and

(v) to operate suitable schemes which will assist medium and large industries to get larger working funds from other institutions.

125. Along with the development and expansion of existing industries and extending help to setting up of new industries, the IDBI should open a special division to provide finance and credit for helping to implement a vigorous programme of rehabilitation and modernization of the industries of the country. These loans for modernization may have to cover a higher percentage (upto 80%) of Capital assets as was done by the NIDC and may have to be given on softer terms. They will have to be repayable over longer period than the other developmental loans for industries.

126. The SFCs will become subsidiaries of the IDBI and will give assistance in all forms to medium and large industries for amounts below Rs. 1 crore. The IDBI, apart from giving refinance to SFCs, will give direct assistance to industry for amounts exceeding Rs. 1 crore.

127. The finances of the SFCs will be drawn from the issue of shares and debentures to the public, discounting bills with the RBI and borrowings from the IDBI. The share capital of the reconstituted SFCs will be held by the IDBI to the extent of 51%, the State Government 25%, the State Bank and nationalised banks and other interests to the extent of 24%. The ratio of capital to borrowings of the SFCs should not be less than 1/5th.

128. The IDBI should have a paid-up capital of at least Rs. 75 crores to be subscribed as follows—

1. Central Government ... ... Rs. 25 crores
2. Reserve Bank ... ... Rs. 25 crores
3. State Bank and nationalised banks Rs. 25 crores

We do not foresee any difficulty in Reserve Bank's finding share capital for this institution. The long-term industrial operations fund has an unutilised balance of about Rs. 20 crores and this could be transferred to the IDBI against share capital subscription of the Reserve Bank. The annual contribution to the fund by the Reserve Bank will cease henceforth and this amount could be utilised by the Reserve Bank in later years for additional subscription of the share capital, if necessary.

129. The IDBI will have to raise resources by issuing debentures to the public and by obtaining loans from the Central Government. It will continue to have the existing facility of obtaining loans from the Reserve Bank and also having its bills discounted with the Reserve Bank.

130. The Board of Directors of the SFCs will be nominated as per the Statute by the IDBI in consultation with the State Governments. The Board of Directors of the IDBI will be constituted by the Central Government in accordance with the provisions in the IDBI Act to be suitably amended or enacted. The composition of the Board of the IDBI must be such as would adequately represent medium and large scale industries, apart from the Reserve Bank, the State Bank, nationalised banks and the Central Government.

Unit Trust of India

131. The development of the Unit Trust of India has been on healthy lines. But when it grows in dimensions it will have to be separated from the RBI. As an independent organisation it will have greater drive and be able to push ahead on its own without encumbering RBI's normal operations.

132. The objective of the UTI is to enable small investor to acquire a share in the industrial growth of the country without exposing his savings to unreasonable risk. The bulk of the funds of the UTI are derived from sale of the units and are invested primarily in shares of industrial enterprises, debentures, and in a limited way, in the bonds of public enterprises. The total investment at the end of April 1968 was of the order of Rs. 41 crores. Thus in a limited period of about four years, the UTI has been able to secure good business in spite of the depressed market for industrial securities.

133. It is not enough to have a single unit trust operating in the whole of India. There should be at least five to six independent unit trusts in the public sector to serve different regions. The objective in setting up these institutions is to mobilise larger resources from small and rural investors while keeping a watch on the interests of the small shareholders. More Unit Trusts should be allowed to be promoted and established by nationalised banks and investment Houses and Financing Agencies under a Central Act "Indian Unit Trusts Act", on lines similar to Banking Regulation Act so that the Reserve Bank of India can exercise the sort of supervisory, regulatory and controlling powers which are at present entrusted to the Reserve Bank of India vis-a-vis the scheduled banks. To set up these trusts and to vest them with requisite authority and functions, it will be necessary to enact legislation which would define

the functional powers to be endowed on Unit Trusts, the responsibility which they will bear towards the shareholders and the powers of control and supervision which the RBI should exercise.

Central Small Industries Bank

134. It is common experience that if small and large industries derive financial facilities from the same institutions, there is apt to be bias in favour of large industries. For this reason, it is necessary that a separate bank which may be called a Central Small Industries Bank should be set up by an Act of Parliament exclusively to cater to the needs of small industries.

135. The Board of Directors should consist of a large number of representatives of the Small Scale Industries, experts and economists and organisations connected with the Small Industries Movement alongwith the representatives of the IDBI.

136. The object of the CSIB will be—

1. to give medium and long-term loans and credits to small industries;
2. to undertake hire purchase business;
3. to give guarantees to small scale industries and create the necessary guarantee fund in the organisation;
4. to operate suitable schemes to enable small industries to get larger working funds from other institutions; and
5. to undertake such other business as the Central Government may direct from time to time.

The working capital loans will continue to be given to small industries by the State Bank, nationalised banks and other commercial banks with such suitable guarantees as from the CSIB.

137. The hire-purchase business will be a separate department of the Central Small Industries Bank which can take over the functions of the existing National Small Industries Corporation. It was thought at one time that the NSIC should be converted into a banking institution. But the limited scale of operations and the nature of business of the NSIC do not favour such a step. Hire-purchase is only a small part of the overall activity of development and can be more profitably made one of the functions of the Central Small Industries Bank. For this reason, the CSIB should take over the assets and the functions of the NISC which should be wound up. The Small Industries Service Institutes and the Small Industries Departments will supply information and extension services, as now, to small industries about the growth potential in different fields.

138. The initial capital of the CSIB will have to be Rs. 20 crores subscribed as follows—

Central Government	Rs. 5 crores
IDBI	Rs. 5 crores
RBI	Rs. 5 crores
State Bank, nationalised banks and Cooperative Banks	Rs. 5 crores

139. The CSIB should, like other institutions, be run on strict commercial lines. Like the IDBI, the CSIB should not exceed borrowings beyond five times the paid up capital.

140. The Central Small Industries Bank will operate through the State Small Industries Bank which should be set up in each State as a company with capital of Rs. 1 to 2 crores. 1/3rd shares of the CSIBs will be held by the Central Government, 1/3rd by the State Governments and 1/3 by small industries, State Bank and nationalised banks. The Small Industries Cooperative Banks, wherever they exist, should be allowed to act as agents of the Central Small Industries Bank and no new Bank for Small Industries need be started in these States. The State Small Industries Corporations should be merged with the respective State Small Industries Banks who can take over the hire-purchase and other present activities of the NSIC.

Export Bank of India

141. Export credit has become an important instrument of foreign trade the world over. No doubt, commercial banks in India have played their part in finding short term finance. But in the context of India's growing export trade, the need for a specialised financing institution such as Export Bank of India for providing comprehensive export credit guarantees including risk insurance as to which the exporting community may turn for their medium and long-term finance, is patent.

142. International competition is severe; and India will have to compete in international trade on equal terms. Therefore, it is imperative to have a financing agency, with its own expertise, capable of providing expeditiously the requisite export finance in a growing economic environment. In the advanced countries—U.K., France, West Germany, U.S.A., Japan, to name only a few—such institutions have been set up with remarkable results.

143. The proposed agency should be designated as the Export Bank of India. The primary purpose of this institution should be to stimulate the country's export trade, through its credit and guarantee operations. To the extent possible the export bank should leave short-term finance to the State Bank, nationalised banks and other commercial banks. But we foresee a possibility in which the overseas orders, in course of time, would be so large, as cannot be easily financed by a single bank. In such an event, the Export Bank of India, under its own leadership, would entrust the transaction to a consortium of banks, who would be on its panel.

144. But, by and large, the E.B.I. would devote its energies and resources to financing medium and long term credit operations. Economic development is taking place all over the globe. The developing countries require imported raw materials, machinery and technical know-how for their economic growth. There was a time when India was at the receiving end; but now she can play a significant part in the economic progress of the relatively less developed countries.

145. The E.B.I. should be set up under an Act of Parliament. With a view to keeping its status high, which is at once necessary for a healthy and rapid development of our export trade, it should have, in brief, the following functions—

(i) to stimulate India's export trade through its credit and guarantee operations, medium and long-term:

(ii) to provide credit and guarantee payments to overseas buyers, private and public, for the purchase of Indian goods, equipment, technical know-how and associated services;

(iii) to provide finance to the Indian exporters, with or without recourse, by making immediate payment in respect of orders which have to be financed on credit terms; and

(iv) to take over the entire export risk insurance and export guarantee operations that are at present handled by the ECGC along with all the assets and liabilities by the ECGC which will be wound up.

NOTE—The bulk of the export finance for short periods, i.e., upto 5 years. is to be found by State Bank, nationalised banks and other commercial banks; but in the event of large orders, too big for a single Bank to handle, the EBI may finance the transaction through a consortium of Banks.

146. ECGC offers its insurance cover on the overseas buyers to the extent of 80%, in respect of the commercial risks and 85% in the case of political risks. However, at the moment, its indemnity to the banks in respect of its packing credit and post shipment guarantees is restricted to 66.2/3%. Thus, the banks are called upon to share a considerable incidence of loss, in the event of exporter's default; and consequently, they hesitate to finance many a promising export propositions. The Joshi Committee had, therefore, recommended—and we endorse this recommendation—that this indemnity under ECGC's packing credit and post shipment guarantees should be raised to 80%, so as to bring it in parity with its standard policies. That indeed will make the aforesaid guarantees more popular and, at the same time, will help the banks, in a measure, to follow a more liberal policy.

147. The domestic prices in India are still out of alignment with the f.o.b. values. The ECGC has, therefore, introduced guarantees, which seek to find for the exporters, through his bank, post shipment finance upto 50% over and above the f.o.b. value. We understand that very little use of these guarantees is being made by the banks, chiefly, because the ECGC's indemnity is limited to 75%/66.2/3% of the loss. The indemnity in regard to these guarantees should also be raised to 80 or 85%.

148. To begin with, the paid up capital of the EBI should be Rs. 15 crores, which should come from the following sources—

1. Central Government	... ...	Rs. 3 crores
2. RBI	... ...	Rs. 3 crores

3. State Bank	...	...	...	Rs. 3 crores
4. Nationalised banks		...	...	Rs. 3 crores
5. LIC	...	...	...	Rs. 3 crores

The paid-up capital of the EBI should not be less than 1/20th of the total volume of its business.

149. The Board of Directors of the EBI may consist of representatives of the Central Government, RBI, the State Bank of India, nationalised banks and representatives of Export Organisation. There would need to be advisory councils to deal with matters in which the exporting community are to be consulted.

National Credit Guarantee Fund

150. There may eventually have to be a separate Fund for the purpose of executing coordinated pattern of guarantees as well as counter-guarantees for all types of loans and credits. This Fund, which may be called National Credit Guarantee Fund, will generally give counter-guarantees to all categories of credits to trade, industry, export, import and agriculture advanced by other institutions.

151. The National Credit Guarantee Fund can eventually take over the guarantee functions of the Export Guarantee Organisation and the credit guarantee scheme of the RBI with respect to small industries and the Deposit Insurance Corporation which at present is under the management of RBI. Apart from these, the National Credit Guarantee Fund, when established, can take over the guarantee operations of the NACB, IDBI, CSIB and EBI with respect to long-term industrial loans, undertake all guarantees of foreign long-term loans utilised by the public and the private sector industries and services, and all guarantees given by the Government of India to the State Bank in respect of loans given by the State Bank to public sector undertakings.

152. It is understood that there is a proposal to set up a Guarantee Corporation for fertilisers and agricultural inputs. This Guarantee Corporation can also be merged into the National Credit Guarantee Fund.

153. The most important field which the different financial institutions will have to explore is the giving of guarantees to poorer and vulnerable sections of society like (i) farmers with small holdings (ii) technicians and technocrats (iii) small industries and (iv) organised groups of smaller exporters who do not have tangible assets but whose talents ought to be utilised for the development of agriculture and industry. To provide services for guaranteeing operations, which in the opinion of Government are vital for social and economic betterment of the poorer sections of the community and for which Government may announce necessary policy decisions, will have to be the functions of the different guarantee funds of the new developmental financing institutions.

154. The initial Guarantee Fund of the NCGF, when formed, may be of the order of Rs. 50 crores. The organisation should establish a ratio of 1:50 between its capital and the volume of business.

The Fund capital should be subscribed by the RBI and the Central Government. The Fund should act as a re-insurance Fund also.

155. The Board of Directors of the National Credit Guarantee Fund should consist of the representatives from different financial institutions like the RBI, the IDBI, State Bank, nationalised banks, Central Small Industries Bank, National Agricultural and Cooperative Bank, Export Bank, apart from representatives of the Central Government.

156. However, this is only a thought and we do not recommend constituting the National Credit Guarantee Fund at this stage for some years to come.

Banking Coordination Committee

157. The operations of the Reserve Bank of India, the National Agricultural and Cooperative Bank, the Industrial Development Bank, Unit Trust of India, the Central Small Industries Bank, and the Export Bank of India have to be coordinated to ensure that the credit system as a whole works on a systematic basis, in accordance with the Plan priorities and within the overall framework of Governmental policies. Therefore, the Chairman of each of these institutions should be a member of a 'Banking Coordination Committee' which can meet at regular intervals. The Governor of the RBI should be the Chairman of the Banking Coordination Committee.

158. The Banking Coordination Committee should function as an arm of the National Credit Council. The scope of the Council itself will have to be expanded to cover medium and long-term credit. The National Credit Council will then be the highest policy making body with respect to all types of credits for the development of the economy. To establish an effective liaison between the National Credit Council and the Banking Coordination Committee, the Chairman of financial institutions including the IDBI, NACB, UTI, CSIB and EBI should be *ex officio* invitees to the meetings of the National Credit Council particularly when the Council discusses issues relating to medium and long-term credit.

159. The scheme as envisaged will put the whole credit system on a rational basis. The RBI will be relieved of a number of responsibilities and be able to function more properly as a Central Bank. At the same time, the credit requirements of different sectors like small and large industries, agriculture and exports will be studied, planned and met adequately by the different specialised institutions. This form of credit system will also enable Government to exercise greater control on the allocation of resources between small and large industries, agriculture and exports and thus bring about harmony between the Plan and the Budget.

Sd/-
MANUBHAI SHAH
Chairman

Sd/-
B.D. SHARMA
Secretary

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