APPENDIX TO "SUMMARY STUDY OF THE ECONOMY OF INDIA"

THE BANKING SYSTEM OF INDIA

Banking in India may be divided into two categories; the organized banking system and indigenous banking. Organized banking is of relatively recent origin and is essentially a Western importation rather than an outgrowth of domestic financial and credit institutions. Indigenous banking, on the other hand, is probably as ancient as commerce itself in India.

Organized Banking consists of (a) The Reserve Bank of India, (b) the so-called Scheduled Banks including the Imperial Bank of India, the foreign controlled Exchange Banks, and the larger Joint-Stock Banks, (c) the Non-Scheduled Banks composed, primarily, of the smaller joint-stock banks incorporated under the Indian Companies Act of 1913, and (d) special types of banking and saving institutions such as the Postal Savings Banks, the Cooperative Credit Banks and the Land Mortgage Banks.

Indigenous Banking in India comprises a large and heterogenous group of individuals and partnerships throughout India (most commonly called shroffs) engaged in lending money, dealing in internal bills (hundis), and accepting deposits. Their number is perhaps something between 300,000 and 400,000. They are not registered under the Indian Companies Act and are not subject to central bank or governmental regulation, except for certain provincial laws prescribing methods for maintaining account and limiting interest rates. Nevertheless, their rates are high, ranging from 8 to 12 per cent on loans with good security and up to as much as 100 per cent on other types of loans and credits. Usually their banking functions are an adjunct of trading or some other form of commercial activity. Liability is unlimited and a major

part of their credit activities are most commonly based upon personal capital rather than deposits. The indigenous bankers seldom permit withdrawal by check and consequently do not participate in clearing operations. They are not obliged to publish their accounts.

The principal link between organized and indigenous banking is the practice by the larger shroffs during periods of heavier credit demand of discounting part of their bills with the joint-stock banks. The Imperial Bank of India is the most important source of such financing. These larger shroffs in turn discount bills for and extend credit to the smaller indigenous bankers. Consequently there is some tendency toward uniformity between the indigenous bill rate and the joint-stock bank discount rate during the season of heaviest crop movements. In general, however, there is wide variation in credit rates between organized and indigenous bankers, on the one hand, and among the indigenous bankers, on the other.

Relative Importance of Various Banking Institutions

The role of different types of banking institutions varies with respect to different monetary and financial aspects of the Indian economy.

While there is little quantitative data on indigenous banking, it is generally agreed that it predominates by far in internal financing. One estimate during the 'thirties placed its importance in this respect as of the order of 90 per cent of the whole. While this may be somewhat exaggerated, figures in the following table on the relative proportions in India and certain other countries of currency and deposit money indicate, in the absence of more accurate measures, the limited development of an organized banking system in India.

Table I

Percentage of Currency and Deposit Money in the Monetary Supply of Various Countries

	Currency		Deposit Money	
	1938 %	1947 %	1938 %	1947 %
United States	18	23	82	77
United Kingdom	28	26	72	74
Italy	47	49	53	51
Brazil	33	39	67	61
Australia	26	22	74	78
India	70	63	30	37

Source: International Financial Statistics

While the above figures are only a very rough indicator of the importance of organized banking, most discussions of the subject state that the bulk of financing in internal trade, small scale industry, and agriculture is handled by the indigenous bankers while internal financing by the joint-stock banks is of major importance only in the principal cities and among the larger commercial and industrial firms.

On the other hand, the financing of external trade is the exclusive domain of organized banking. But this field is virtually a monoply of the handful of foreign controlled Exchange Banks.

In the mobilization and channeling of savings there is no basis for determining the relative importance of annual increases in the savings deposits of joint-stock, postal, and cooperative banks to the total annual supply of liquid savings in India. It is generally agreed, however, that the flow of

small savings into organized savings institutions is small in comparison with cash and ornament hoardings, individual money lending, and investment in land, buildings, and small scale enterprises. During the period from 1938 through 1947 when the volume of currency in circulation increased by more than Rs 13,000 million, the annual average addition to time deposits of all joint-stock banks and to all deposits and investments with postal savings banks amounted to only about Rs 475 million.

In general, it may be stated that outside the sphere of external finance, organized banking along Western lines in India is relatively underdeveloped in relation to the financial requirements and capital needs of the country. Consequently the Indian money market is a loose and heterogenous system with little uniformity among rates and credit practices. Qualitative controls over credit are limited by the restricted area of central bank jurisdiction, and quantitative controls are handicapped by the disorganization and lack of integration in the money market, and by the absence of a developed bill market. Throughout large sectors of the economy credit is available only at exorbitant rates, while a history of frequent failures has tended to undermine confidence in banking institutions. Although the development of branch banking has been particularly rapid in the past ten years, facilities both for credit and deposits are still far from adequate, leaving a wide field for the usurious practices of the small money-lender. Finally, the system as a whole lacks the high degree of flexibility necessary to the sharp seasonal fluctuations in the demand for financing.

Components of the Organized Banking System

1. The Reserve Bank of India. This was organized in 1935 to perform the usual functions of a central bank. It is a shareholders bank but has recently

been nationalized under legislation to become effective on January 1, 1949. The principal elements of its control over the organized banking system consist of (a) requirements that Scheduled Banks maintain minimum deposits with it--5 per cent on demand and 2 per cent on time deposits--and submit weekly returns of their accounts, (b) open market operations, and (c) regulation of the rediscount rate. The latter, however, is of only limited importance in view of the absence of an organized bill market. Legislation extending and strengthening its powers of control has been pending for some time but has not as yet been enacted. However, by Ordinance of September 18, 1948 the Reserve Bank was granted additional powers to exercise qualitative controls over unsecured loans and advances and other lending practices of banking companies.

In addition to its control and credit functions the Reserve Bank accepts deposits, acts as fiscal agent for the government, and has responsibility for the currency issue and the maintenance of the legal exchange rate of the rupee in relation to sterling.

2. Scheduled Banks. Banking companies designated as Scheduled Banks by the Reserve Bank of India comprise the major part of the organized Indian banking system. With minor qualifications they include all banks having paid-up capital and reserves with a market value in excess of Rs 500,000. As of March 1948 there were 101 Scheduled Banks in India. Branches of Scheduled Banks numbered almost 3,500 at the end of 1946 and accounted for almost 90 per cent of all deposits held in joint-stock banks in India. The Scheduled Banks may be divided into three categories:

(a) The Exchange Banks. These are Indian subsidiaries of foreign banking institutions. They specialize in the financing of India's external trade

where they have a near monoply. They also accept deposits and do some financing of internal trade although this is a relatively minor aspect of their operations. There are 15 Exchange Banks. At the end of 1946 they had 77 branches and held deposits in India amounting to about 15 per cent of total joint-stock bank deposits. Seven of the Exchange Banks are British, 2 each are Dutch, American, and Chinese, one is Portuguese, and one is French.

(b) The Imperial Bank of India. The Imperial Bank occupies a special position by reason of its large resources, widespread facilities, and special relations with the Reserve Bank. It is the largest bank in India. As of the end of 1946 it had 443 branches and held deposits amounting to 23 per cent of the deposits in India of all banks with capital and reserves in excess of Rs 500,000. Within the organized banking system it is the principal source of short term agricultural financing. It is also the chief lender of inter-bank call money. It is authorized to deal in foreign exchange but this function is left primarily to the Exchange Bank.

The Government of India has indicated approval, in principle, of nationalization of the Imperial Bank although no specific steps in this direction have been taken. The directorate and management of the bank is mainly non-Indian.

(c) Other Scheduled Banks. The most important of these are the Central Bank of India, the Bank of India, the Allahabad Bank, the Punjab National Bank, the Bank of Baroda, the Bharat Bank, and the United Commercial Bank. These seven accounted for 57 per cent of all deposits of Scheduled Banks, excluding the Exchange Banks and the Imperial Bank, in 1946.

Information on the extent of foreign participation in their ownership is limited. The Allahabad Bank is primarily British. There is apparently

also an important element of British control in the Bank of India, the Bank of Baroda, the Bharat Bank, and the United Commercial Bank. Management of the Central Bank of India and the Punjab National Bank is reportedly almost entirely Indian although securities of the former are quoted on the London stock exchange.

3. Non-Scheduled Banks. This category covers joint-stock banks, other than the Scheduled Banks, registered under the Indian Companies Act. It includes primarily banks whose paid-up capital and reserve has a market value of less than Rs 500,000.

According to the Reserve Bank of India there were 706 such banking companies in British India and the principal native states in 1946. Their deposits amounted to only about 10 per cent of total joint-stock bank deposits, and the majority had less than Rs 100,000 in paid-up capital and reserves. Most of these banks are required to submit monthly returns and to hold minimum cash reserves in proportion to demand and time liabilities.

4. Other Organized Banking Institutions.

(a) The Postal Savings Banks have been established in India for over half a century. Their total deposits at the time of partition amounted to about Rs 1,500 million as compared with Scheduled Bank time liabilities of Rs 3,400 million. While the Postal Savings Banks constitute one of the principal depositaries for small savings, they are not available in many of the Indian towns and are in only a small fraction of the Indian villages.

(b) The Cooperative Banks are organized by urban and rural cooperative credit societies. These are in turn federated into Central Cooperative Banks which are further federated into Provincial Cooperative Banks. The basic societies are associations of individual borrowers and non-borrowers usually

in a single locality. Their funds are raised from entrance fees, share capital, deposits, and loans from the Central Cooperative Bank with which they are associated. The Central Banks obtain financing from the Provincial Banks and both accept deposits from the public.

At present there are more than 125,000 cooperative credit societies, almost all of which are in rural areas. However, they serve the financial needs of only a small proportion of the agricultural population. Furthermore they have had a high record of insolvency and overdue indebtedness.

(c) Land Mortgage Banks are a relatively recent development in India and have been organized, usually on cooperative lines, for extension of long term agricultural credit, for funding of old debts and for land purchase and improvement. Mortgage banking generally consists of primary mortgage banks linked to a central mortgage bank. In 1946 there were 284 primary mortgage banks. Over 40 per cent of these were in Madras.

The role of the Land Mortgage Banks is relatively minor in terms of the financial requirements of Indian agriculture. In 1946 the total working capital of the primary mortgage banks amounted to only Rs 37 million and outstanding loans were Rs 34 million. Loans made during 1945-46 totaled only Rs 6.5 million.

Table II

Statistics of Organized Banking in India
1946

	Branches No.	Cash Position (Rs 000,000)	Investments (Rs 000,000)	Loans and Advances (Rs 000,000)	Deposits (Rs 000,000)
Imperial Bank of India	443	425	1545	943	2717
Exchange Banks	77	320	1/	1/	1813 2/
Other Scheduled Banks	2949	1208	2793	3070	6242
Non-Scheduled Banks	2688	339	376	681	1224
Cooperative Banks 3/	579	74	-	353	714
Postal Savings Banks	12631 4/	NA	NA	NA	2550 5/

NA = Not Available

1/ Available figures combine operations outside as well as within India. No information for India alone.

2/ Exchange Bank deposits within India.

3/ Cooperative Banks with capital in excess of Rs 100,000.

4/ Number of Postal Savings Banks in 1938.

5/ Includes savings deposits, cash certificates, defense savings certificates, defense savings deposits, and national savings certificates.

Source: Reserve Bank of India, Statistical Tables Relating to Banks in India, 1946.