CHAPTER VII

COMMERCIAL BANKS AND RURAL CREDIT

The Problem of Rural Credit

The Indian economy is essentially rural in character. The urban superstructure is a minor part of it. With a programme of rapid industrialisation, the importance of the rural sector will increase rather than diminish. Proper development of rural financial institutions is an absolute necessity if all round economic growth is to be achieved. Financial institutions in rural areas are to perform two important functions. First, a mobilisation of idle rural savings, so that they may be used more productively. Secondly, to supplement and, if possible, to substitute existing financial agencies for rural credit so that such credit may be obtained more adequately and on more reasonable terms.

While the need for credit is vital to the rural producer, he never gets sufficient credit, nor is he able to dictate his own terms. The difficulties originate both from the peculiarities of the rural occupations and from the inadequacy of existing financial institutions. They are related problems and arise from several sources, such as, the predominantly small unit of production and subsistence character of the occupation, financial weakness and illiteracy of the cultivator, the long production period involved, the inadequate security which he can offer against loans, uncertain nature of the produce and hence, his unpredictable credit-worthiness, his habit of borrowing to meet consumption requirements, inadequate means of transport and communication to the rural areas etc.

Credit needs of the agriculturist are both large in volume and varied. The bulk of the farmers are quite heavily indebted. According to the Rural Credit Survey Committee Report (1954), in 43 out of 75 districts studied in
India, 50 to 90% of the families of small cultivators reported having borrowed during 1951-52.\(^{(1)}\) Small cultivators, on their part form the majority among all classes of cultivators. Later Rural Credit Follow-up Surveys bear to the same evidence.

As regards variety, credit needs of the rural people can be divided both according to the period and according to purpose for which the debt is incurred. Loans may be short-term, medium-term and long term. The purposes for which loans are contracted may be roughly divided into those of production and consumption. The essential part of consumption loans is that which the producer must incur to bridge the time interval between the sowing of seeds and the harvesting of crops. But loans contracted for ceremonials stand on a different footing. An important part of the problem of rural credit is the need to restrict borrowing for wasteful social purposes along with the need to secure that the normal and necessary borrowing for consumption is fully met.

The findings of the Rural Credit Follow-up Survey for 1956-57 showed that in 6 out of the 11 districts surveyed, debt incurred for consumption purposes was more important than debt incurred for agricultural purposes. Among debt incurred for consumption purposes, again, long term debts were more important which meant that debt incurred for uneconomic consumption requirements exceeded in importance borrowings made for bridging the normal gulf between production and consumption. This report is confirmed by the later Follow-up Surveys. Therefore the purposes for which borrowings are made are often not in keeping with Commercial Banking Principles.

These surveys also show that although a considerable proportion of the

\(^{(1)}\) All India Rural Credit Survey, Vol.I, Part I, pp. 235-236
credit is extended for short-term (in 6 out of 9 districts more than 50% of the loan was for less than one year in 1959-60), the cultivator can seldom repay his loans in time. (1) So they roll on from year to year and thus amount to long-term or medium-term loans in practice. It is inconsistent with the nature of commercial banking to make loans for such indefinite periods.

Thirdly, the security offered against loans by the cultivator is not of a type acceptable to a commercial bank. The major part of the loans are made against personal security. Next in importance is the security of immovable property. The commercial banks do not have close links with the villages. So it is difficult for them to lend against personal security. Nor can they accept immovable assets as security, more so as the cultivator often does not have secure titles to land.

Due to all these circumstances, commercial banks have made little penetration into the rural areas. Alternative financial institutions also have not grown up for the same reasons.

Different Credit Agencies and the Part Played by Commercial Banks

The All India Rural Credit Survey, 1954, shows the part played by all the credit agencies in providing rural credit during the year 1951-52. (2) According to this Survey about 93% of the total lending is done by private agencies including money lenders, traders, relatives and commission agents. Commercial banks lend barely 1 per cent of the total. The experience of 1951-52 is repeated in later years. According

(1) Rural Credit Follow-up Survey, 1959-60, P.37.
to the Rural Credit Follow-up Survey for 1956-57 in 9 out of the 11 selected districts, borrowings from commercial banks were nil. The predominant part was played by private credit agencies. Even if relatives were excluded, other private agencies (mostly including money lenders and traders), provided as much as 99% of the total borrowings in one district and 90%, 93%, 96%, 77%, 75% etc. in the others. With the exception of the district of Khandesh, nowhere did it fall below 47%. (1)

Money lenders possess several advantages over institutional credit agencies in their informal methods of business, ready availability of credit and close personal contact with their borrowers. The importance of moneylenders in the rural areas is in itself a reflection of the undeveloped state of institutional credit agencies. Least active among the institutional credit agencies, again, are the commercial banks. Hence, in India, commercial bank advances to agriculture form a very negligible proportion of total advances.

The Rural Credit Survey Committee, 1954, indicated that even the small amount obtained from commercial banks was usually confined to several districts and it went largely to the upper strata of cultivators. The greater part of the independent, small-scale cultivators, who formed the bulk of agricultural producers, were, therefore, deprived of commercial banking facilities. Inadequacy of institutional agencies is a common experience in most underdeveloped countries, as is evident from the following table:

---

(1) All India Rural Credit Follow-up Survey, 1956-57 P.271
Per Capita Utilisation of Institutional Agricultural Credit,
Selected Countries, 1953 (United States dollars)

<table>
<thead>
<tr>
<th>Country</th>
<th>Credit in use per head of agricultural population</th>
</tr>
</thead>
<tbody>
<tr>
<td>Burma</td>
<td>0.3</td>
</tr>
<tr>
<td>Cambodia</td>
<td>0.3</td>
</tr>
<tr>
<td>Ceylon</td>
<td>2.9</td>
</tr>
<tr>
<td>India</td>
<td>6.0</td>
</tr>
<tr>
<td>Philipines</td>
<td>12.4</td>
</tr>
</tbody>
</table>


The poor development of credit institutions is reflected in the high level of interest rates prevailing in the underdeveloped economies. Data given by the All India Rural Credit Follow-up Surveys show that interest rates have been lower in the relatively developed monetised economies where, incidentally, the co-operative movement also recorded better progress, than in the low monetised subsistence economies.
The Rural Credit Follow-up Survey for 1959-60 shows that the range of interest rates between 9-3/8 and 12% has been quite common. Borrowings at rates ranging from 13 to 25% formed 21 to 32% of total borrowings in 5 out of 9 districts. Borrowings at rates of 25% and above formed 29% of all borrowings in two districts, 19% and 21% of the total in two others. (1) Interest rates charged by money lenders are unjustifiably high in all underdeveloped countries. Thus, in Cambodia, interest rates may range between 7 and 10 per cent per month; in Indonesia the rates vary between 50 and 100 per cent per year. (2) Rates of interest paid by tenants in the Philippines range from 25% to 400% per annum. (3) Rates of interest may be nil or low provided the whole of the produce is handed over to the merchant lenders concerned.

The high rates of interest reflect both the absence of any effective alternative source of credit and the greater risks that agricultural credit involves. The cumulative effect of high rates of interest, low prices received from the sale of agricultural produce and the various malpractices of moneylenders is that debts once contracted keep on accumulating. The ultimate result is alienation of land from the cultivator.

Importance of Commercial Banks in the Field of Rural Credit

In spite of all difficulties it will be incorrect to presume that the commercial banks have not played any part in financing agriculture. They have indirectly served the rural areas to a large extent. The All India Rural Credit Survey Committee pointed out that commercial banks

(1) All India Rural Credit Follow-up Survey, 1959-60, P.56-57.
(2) All India Rural Credit Survey Report, Vol.II, P.173.
(3) United Nations - Progress in Land Reforms, P.213.
provide agricultural finance indirectly through the village money lenders, the urban money lenders, the indigenous bankers and the trader in agricultural produce.

Commercial banks have been more interested in financing marketing than production in agriculture. Commercial banking facilities, therefore, have been concentrated in those areas where marketing activities in agricultural produce are largely concentrated. This has resulted in an unbalanced regional distribution of bank branches. This is quite natural since the more commercialised areas attract more business, have lower operating costs and yield larger profits. These advantages are also cumulative in character.

In agricultural marketing, commercial banks have played quite an important role, in financing the movement of agricultural goods at all stages from primary production to final consumption. Even in this respect, however, extension of credit facilities by commercial banks has been obstructed by many factors. One factor is the absence of good and adequate storage facilities which makes it difficult for banks to lend against the security of produce. Secondly, in the absence of licensed warehousing to a large extent, commercial banks are not able to lend against the security of warehouse receipts. Another inhibiting factor is the lack of adequate branches in the rural areas and of close connection with the rural population. Despite these difficulties the volume of financing done by commercial banks for the marketing of agricultural produce has not been negligible. This will be corroborated by the table given below:
Commercial Bank Advances Against Agricultural Produce

Comparative figures, 1951 and 1960.

(Amount in crores of rupees)

<table>
<thead>
<tr>
<th>Outstanding as on</th>
<th>Non-scheduled banks</th>
<th>Scheduled Banks</th>
</tr>
</thead>
<tbody>
<tr>
<td>September 30, 1951</td>
<td>45.15</td>
<td>531.5</td>
</tr>
<tr>
<td>October 28, 1960</td>
<td>30.23</td>
<td>1100.0</td>
</tr>
</tbody>
</table>

(2) Advances for wholesale trade in agricultural commodities

<table>
<thead>
<tr>
<th></th>
<th>Non-scheduled banks</th>
<th>Scheduled Banks</th>
</tr>
</thead>
<tbody>
<tr>
<td>September 30, 1951</td>
<td>3.51</td>
<td>64.1</td>
</tr>
<tr>
<td>October 29, 1960</td>
<td>2.39</td>
<td>72.5</td>
</tr>
</tbody>
</table>

(3) (2) as percentage of (1)

<table>
<thead>
<tr>
<th></th>
<th>Non-scheduled banks</th>
<th>Scheduled Banks</th>
</tr>
</thead>
<tbody>
<tr>
<td>September 30, 1951</td>
<td>7.8</td>
<td>12.1</td>
</tr>
<tr>
<td>October 29, 1960</td>
<td>7.9</td>
<td>6.6</td>
</tr>
</tbody>
</table>

* Source: Annual reports on Trend and Progress of Banking, Reserve Bank of India — Analysis of advances according to purpose.

Advances for wholesale trade in agricultural commodities form quite a sizeable amount. Their proportion to total advances, however, diminished sharply in the case of the scheduled banks between 1951 and 1960. This is explained partly by the slower rate of growth in agriculture than in other sectors of the economy and partly by the selective credit control measures imposed by the Reserve Bank.

There is a general belief that commercial banks cannot, and should not try to enter the field of rural credit, because it is too risky and inconvenient and secondly it is the proper field of activity only for the co-operative institutions. Any entry of commercial banks into this field will only mean wiping out of the surplus resources of the rural areas and unhealthy competition with co-operative institutions. This idea is not
correct. In a reorganised rural credit structure both commercial banks and co-operative institutions will have important roles to play. In the opinion of the Rural Banking Enquiry Committee, "Both in respect of functions as well as clientele, there can be a broad division of labour between commercial and co-operative banks and their activities can thus be coordinated." (1) The Reserve Bank of India Act, 1934 which renders agricultural finance available largely through co-operative societies, gives a very high place to scheduled banks. Close connection with scheduled banks and provincial co-operative banks is one of the essential conditions for the availability of Reserve Bank finance for agriculture under section 17(2)(b) of the Act. Until September 1964, the Reserve Bank of India had been giving concessional rediscounting facilities to scheduled banks in respect of their advances to the co-operative sector.

Integrated Scheme of Rural Credit

There has been growing consciousness of the magnitude and variety of the problem of agricultural credit in recent years. This has led to an increased appreciation of the need for an integrated and comprehensive approach to the problem of rural credit. It is being felt that not only should credit be obtained on easier, more reasonable terms, but that credit institutions should also aim at an all round development of the rural life. The issue is not that of supply of credit for this or that specific purpose, but that of raising the overall productivity of the whole agricultural set up. This approach has three implications, as is pointed out in a paper published by the ECAFE of the United Nations. (2)

(1) Rural Banking Enquiry Committee Report 1950 pp.50-51
(2) Credit Problems of Small Farmers in Asia and the Far East—study prepared by the ECAFE/FAO Agricultural Division Bangkok 1957, p.18
(1) Better appreciation of the role of co-operatives;
(2) awareness of the intimate connection between agricultural credit and marketing (3) basing agricultural credit on the productive capacity of the borrower, rather than on the security of immovable property.

The co-operative framework, because of its democratic character and the scope it offers for individual initiative, provides the best means of placing agriculture on a sound footing.

Secondly, more provision of credit without perfecting the marketing arrangements is meaningless. An integrated system can facilitate supervision of the use of credit as well as its repayment, and can better withstand the competition of private traders and money lenders.

Thirdly, agricultural credit based on the productive capacity of the borrower (accompanied by proper supervision of credit) is feasible and should replace credit based on the security of immovable property. For, thus alone can a large number of small cultivators, particularly sharecroppers and tenants at will have access to institutional credit.

This new approach is exemplified through recent developments in institutions in India and the Philippines. In the Philippines it is typified by the Agricultural Credit and Co-operative Financing Administration (ACCFA) and in India by the establishment of the State Bank of India and other associated developments. The growth of institutional credit in Japan also shows this integrated approach to credit and marketing. It is evident that in this integrated and comprehensive scheme for agricultural credit, commercial banks will come to play a vital role.

First, commercial banks can act as important sources of marketing finance. According to the All India Rural Credit Survey, "While commercial banks have little or no significance for agricultural production, they may, if suitable conditions are created, acquire considerably greater importance
than at present for agricultural marketing." (1) In its statutory report, 1937, the Reserve Bank of India also expressed the opinion that the commercial banks were the best intermediaries for financing the movement and marketing of crops.

The importance of providing finance for the marketing of agricultural produce arises from the fact that in the absence of proper marketing facilities, agriculturists are often exploited by middlemen. Examples are provided by almost all countries of East and South East Asia, where the shopkeeper or trader and the money lender are often the same person. The cultivator usually receives a price which is lower than the market price. He is also cheated by various malpractices on the part of the money lender or trader, such as underweighing or illegal deductions of various kinds. The money lender does not pay higher price for produce of better quality. So the cultivator has no incentive to improve or maintain the quality of his produce. The cultivators also get grain loans, which deters any effort at crop planning.

The commercial banks will find it easier to lend through the co-operative institutions than to individual subsistence farmers. The co-operative societies would also be better intermediaries to provide indirect finance through, than money lenders, as the latter would only exploit the producer.

Apart from the provision of marketing finance, the commercial banks can help the rural credit structure in several other alternative ways. First, by contributing to the capital of agricultural credit institutions and investing in their securities. Thus, commercial banks are important.

(1) All India Rural Credit Survey Committee, General Report, Vol.II, P.324
participants in the share capital of the Agricultural and Credit Co-operative Bank of Egypt and the Agricultural Bank in Cyprus. Where these institutions are state-associated, or their shares are guaranteed by the state, commercial bank participation is easier. Secondly, while commercial banks cannot help production directly, they can provide assistance indirectly through co-operative institutions. In India, the provision of commercial bank credit to co-operative institutions is small in volume - about 7% of the total, but in Cyprus, the Barclay's Bank has been the major source of working capital for the co-operative credit institutions.(1)

The development of co-operative institutions would lead to the development of sound arrangements for marketing, storage and warehousing etc. The warehouse receipts can be used by commercial banks as collateral for purposes of rediscounting with the Central Bank. Thus the growth of healthy co-operative institutions is a necessary precondition for the extension of credit facilities by commercial banks.

Finally, commercial banks can help to strengthen the co-operative organisations by providing them with cheap and ready remittance of funds and thus lowering the need for holding idle cash. For this, rapid extension of branches is called for.

The role played by the Imperial Bank and other State Associated Banks in Rural Finance

While ordinary commercial banks took very little interest in providing agricultural finance, the Imperial Bank and the other state associated banks had close connection with government policy of satisfying rural requirements. This they did in two days; (1) provision of cheap remittance facilities to

(1) Belshaw - Agricultural credit in Economically under developed countries, FAO of the United Nations, Rome, 1959, P.129
the underbanked areas, and (2) the financing of agricultural commodities important to the economy. As an agent of the Reserve Bank in different parts of the country, the more important aspect of the Imperial Bank's function was that of a provider of cheap remittance facilities. The state associated banks, on the other hand, belonged to the Indian native states. As such, their important function was that of providing accommodation against agricultural commodities, mostly to trade, but in association with the policies of individual state governments. The principal state-associated banks were the State Bank of Saurashtra, the Bank of Patiala, the Bank of Bikaner, the Bank of Jaipur, the Bank of Rajasthan, the Bank of Indore, the Bank of Baroda, the Bank of Mysore, the Hyderabad Bank and the Travancore Bank.

The fact of the Imperial Bank's acting as an agent of the Reserve Bank was of great significance not only to the monetary authorities, but also to the joint stock and cooperative banks. Joint stock banking in India is confined only to the more commercialised areas. In order to transmit funds smoothly from one place to another, large cash balances have to be locked up by the Government in the Treasuries and Sub-Treasuries. The problem is eased whenever there is a branch of the Imperial Bank of India. Commercial banks, too, having branches in the same place as the Imperial Bank, made use of the latter for the remittance of funds. The programme of extension of branches to the rural areas by the Imperial Bank was, therefore, of vital importance both to the cooperative and to the commercial banks. Unfortunately, the Imperial Bank of India did not work up to expectations. Being a private shareholder's bank, it could not but make profit its prime consideration. So up to 1955, its role in the rural credit structure remained negligible.
In 1951-52, the All India Rural Credit Survey Committee appointed by the Reserve Bank of India made a thorough going survey of the working of all rural credit institutions. Important facts about the working of such agencies were brought to light and the Committee made certain recommendations of deep significance. The Imperial Bank of India, which was closely associated with State policy, was expected to perform some important services in the long run interest of banking in this country. These were, the development of rural credit facilities and the extension of banking services all over the country. The expansion of its branches would be an indirect stimulus to the future extension of joint stock banking. However, the Committee of Direction, All India Rural Credit Survey, pointed out that commercial banks, including the Imperial Bank of India touched only the fringe of the problem of rural credit. The branch expansion programme implemented by the Imperial Bank of India did not cover even half of the target laid down by the Rural Banking Enquiry Committee. A far more rapid programme of branch expansion to all rural and semi-urban areas was called for. But being essentially a profit-making shareholders' concern, the Imperial Bank could not be expected to carry out such an ambitious programme. Not was it likely of the other commercial banks. So the Committee recommended a complete reorganisation of the system of rural credit. The re-organised structure was to be characterised by its integrated character and state partnership at all stages of the cooperative credit mechanism in order to place it on sound footings. This partnership would be supplied by the Imperial Bank converted into the State Bank of India. By integrated rural credit
was meant the development of a coordinated structure of cooperative credit for short-term, medium-term and long-term purpose, which should be linked with other economic activities, such as marketing, processing and warehousing etc.

The Committee recommended the integration of the States' financial participation in an important sector of commercial banking (viz, that which in various degrees was already associated with the state, and which, if the banks concerned were made to come together, broadly covered the whole of India), in order that the state-partnered, country-wide banking structure so formed might among other things, be charged with and carry out the positive duty of endeavouring to do its best to help the development of rural and cooperative banking. It was expected to discharge the duty, among other things, principally by cheaper and readier remittance facilities, particularly in the relatively underdeveloped areas.

These principles were to be realised by the "Establishment of a State Bank of India through the amalgamation of the Imperial Bank and certain other State associated banks; major state participation in the new and enlarged institution; the expansion of the State Bank to and beyond district headquarters places; the conversion, through this programme of a large number of non-banking treasuries into banking treasuries; the effecting thereby of a significant increase, especially in underdeveloped areas, of facilities for cheap and ready remittance of money and finally, the responsive support by this institution of the cooperative structure connected with credit and economic activity, especially, marketing and processing."(1)

The Committee recommended that the share capital of the new institution should be expanded. The authorised share capital and the fully paid-up capital were to be increased from Rs 11.25 crores to Rs 20 crores and from 7 crores to Rs 15.35 crores respectively. Together the Central Government and the Reserve Bank should hold a majority of share capital and of votes amounting to not less than 51% of the total. The Government of India and the Reserve Bank would nominate the majority of Directors on the Central Board.

The business of the State Bank would be to help the extension of rural and co-operative banking facilities by active participation, where necessary. For this, the State Bank was intended to implement a vigorous programme of branch expansion within a very short period of time. It was suggested that the programme of branch expansion should cover in as short a period as possible, more than 100 district headquarters and more than 300 sub-divisional centres i.e., 400 new branches in all. There should also be the closest co-ordination, at the sub-divisional centre between the State Bank of India and the state-partnered co-operative banking system. There was great scope and need for such co-ordination. The State Bank of India should act at sub-divisional places as the banker of the state-partnered co-operative bank. It would provide them with adequate remittance and exchange facilities.

About the operations of the State Bank, the Committee was clearly of the opinion that there should be no state interference in the day to day affairs of the Bank. Nor of course, should there be any lowering of the standards of sound banking. The State Bank should try to be responsive to the needs of the co-operative institutions, connected with credit and especially, marketing and processing. Its branch expansion programme should be coordinated with the development of cooperative credit.
particularly through the provision of cheap remittance facilities.

Considering the situation prevailing in India, such an integrated scheme of rural credit with active state participation has much to recommend it. For, the problems of agricultural life in India are many sided. The remedy, also, must be many sided. Secondly it is not enough to take measures against the money lenders. It is necessary to provide effective substitutes. This cannot be done by private institutions, because of the comparative advantages enjoyed by money lenders. This is where the state must step in.

Such state participation in agricultural credit is not something altogether new. Specialised or semi-specialised Governmental institutions have come to play an increasingly important role in extending agricultural credit in recent years. In the far east region, there were 16 such institutions in 1956, according to a United Nations Report. Of these 7 were specialised Corporations, established to finance partly or exclusively agriculture, 2 were special agricultural or mortgage banks, 5 were, however, ordinary Government banks granting loans for agricultural industrial or commercial purposes, viz. (1) The State Bank of India (2) The Bank Rakajat Indonesia, (3) The Bank Industry Nagara of Indonesia (4) The Philippine National Bank (5) The Japan Development Bank. State participation in agricultural credit is becoming wider in Latin American countries too. Prominent examples are the Banco do Brasil, Banco de la Provincia de Buenos Aires.

The commercial banks and the co-operative societies should be of greater use to each other as complementary parts of the integrated rural

credit structure. Extension of the State Bank's branches all over the country will give an indirect stimulus to other banking institutions to extend their branches to hitherto unbanked areas.

The direction in which commercial banking facilities would be of greatest use to the rural people is in the provision of marketing finance. As regards agricultural marketing, one way of developing a closer connection between this activity and the organised money market is to foster the bill habit. Provision of marketing finance at all levels is now done through cash payments. In order that the organised banking section can play a greater role in the provision of marketing finance, it is necessary to replace cash transactions by means of hundis, which will be discounted in the money market. At present the banks indirectly finance the movement of crops from one middleman to another by lending against darshani hundis. They also make advances against the security of produce deposited in their godowns. However, such credit cannot be extended to any great extent by banks because of the unwillingness of merchants and traders to pledge stocks with banks and the rigidity of regulations governing such advances. Better godown conditions of the banks and educative propaganda would encourage traders to make better use of commercial banking facilities.

An important feature of the new scheme of integrated credit is the emphasis placed upon the development of storage and warehousing facilities. A National Co-operative Development and Warehousing Board was set up to take up the charge of the development of storage and warehousing facilities on the one hand and the distribution of the basic requirements to the cultivator as producer and consumer on the other. It would plan and finance such activities by granting loans, subsidies etc. It would draw for this purpose on the National Warehousing
Development Fund. Besides, an All India Warehousing Corporation and State Warehousing Corporations were set up. The former would be in charge of development of storage and warehousing at centres of all India importance. Correspondingly, the latter would be entrusted with the task of development of storage and warehousing at centres of importance at the district or state levels. Development of storage and warehousing into the interior of the district would be the task of the co-operative organisation. The importance of organised storage and warehousing facilities to commercial banks working in the field of rural credit cannot be over-emphasised.

**Functions and Achievements of the State Bank of India**

In the main, the functions of the State Bank remained the same as before. The State Bank would continue to undertake commercial banking functions on recognised business principles (subject to some restrictions) and would continue to provide credit to industry, trade and commerce. The State Bank was also to act as an agent of the Reserve Bank of India at all places where it (or a subsidiary bank) had a branch and where there was no branch of the Banking Department of the Reserve Bank of India.

The State Bank of India was intended primarily to be an institution catering to the rural credit needs. This it was to do in two ways: first, by a widespread network of branches and secondly, by assistance to co-operative institutions.

Grave doubts were originally expressed about the future of a nationalised Imperial Bank of India. It was apprehended that nationalisation might impair the efficient working of the foremost
commercial bank in the country. The working of the State Bank of India has dispelled these fears. So far as the rural credit mechanism is concerned, the State Bank has more than fulfilled the high hopes placed in it. But this has not been at the cost of its commercial banking character.

The Branch Extension Programme

In its Branch Extension Programme, the State Bank of India surpassed expectations. The State Bank of India Act required it to open 400 new branches within a period of five years from July, 1955. The Bank had opened 416 branches by the end of June, 1960. The centres for the new branches were fixed upon several considerations. These were the existence of Government treasury or sub-treasury, extent of existing banking facilities, availability of warehousing accommodation present as well as prospective and whether or not the centre was included in a Community Development Project. In the selection of those centres, preference was given to smaller towns and semi-urban centres in contrast to the bigger towns and cities. Thus the highest density of branches was in areas with a population between 10,000 and 25,000. At 64 centres there were previously no banking facilities at all. For 40 of them no banking facility was available within a distance of 20 miles. That these new branches were becoming important vehicles for extension of cheap credit and mobilisation of savings was clear from their total volume of deposits and advances, which amounted to ₹ 28.7 crores and ₹ 22.2 crores respectively in April 1960. Considering the poverty of the rural people,
the volume of savings was not negligible. The volume of advances also deserved mention for the fact that most of the new branches were running at a loss. The most important objective of the State Bank was to stimulate the development of banking by the provision of cheap remittance facilities. Upto March 31, 1960, the new branches issued remittances at par and at premium to scheduled banks, amounting to Rs 91.5 crores and Rs 16.3 crores respectively. Similar facilities provided to cooperative banks were Rs 22.2 crores and Rs 13.4 crores respectively.

The branch extension programme, however, created two problems. On the one hand, it put a strain on the staff resources at all levels. Secondly, it put a strain on the Local Head Offices as well as the Central Office of the Bank.

On account of these problems, a subcommittee under the Chairmanship of Professor D.G. Karve was appointed in 1960 to go into the problem of branch banking in detail. It was to assess the effects of branches already opened and determine future policy regarding branch expansion by the State Bank and the subsidiary Banks during the quinquennium 1960 - 1965. The sub-committee submitted its Report in May 1961. It recommended that 300 new branches should be opened during the 5 years ending in June 1965. They were to be located in the rural and semi-urban areas. In opening these branches attention should be given, among other things to (a) the extension of remittance facilities (b) the need to establish branches at sub-divisional centres (c) provision of financial services to small scale industries; (d) provision of suitable marketing facilities to cooperative marketing and processing societies; (e) mobilisation of savings. Accordingly the State Bank took up a scheme of starting 300 new
branches. Of these the State Bank was to open 145 branches and 155 centres were allocated to the subsidiary banks. By the end of 1964, all but 49 branches had been opened. At the same time a third expansion programme had been taken up. It was to open 319 branches in non-banking treasury and sub-treasury centres within the period 1964-68. Of these, nine branches were opened during the year 1964. On December 31, 1964, the State Bank of India had 1147 offices, of these the number of offices in small towns and hitherto unbanked centres was 564.(1)

The pressure of work and diversification of activities due the expansion of branches placed the Bank's organisation under some stress. Hence, in order to decentralise authority three new local head offices in Kanpur, Ahmedabad and Hyderabad were opened during the year 1964-65. The total number of head offices became seven. Moreover, the powers and authority of the local boards were increased.

Assistance to Co-operative Institutions

The State Bank of India's assistance to co-operative credit can be discussed under the following headings:

(a) General assistance; (b) Finance for marketing and processing co-operative societies; (c) Finance for land mortgage banks; (d) Warehousing finance.

(a) General assistance

Apart from remittance facilities, the Bank provides general assistance to co-operative credit institutions in the form of loan/overdraft facilities against Government securities at a concessional rate of interest, i.e., 1½% below the State Bank of India advance rate. Co-operative credit institutions

(1) Speech by Dr. B. Venkatapthiah, Chairman, State Bank of India, at the Annual General Meeting, February, 1965
are given advances on the repledge of goods. The Bank provides liberalised remittance facilities to State Co-operative Banks and their affiliated central and industrial co-operative banks under the Reserve Bank's remittance facilities scheme. Secondly, under its own remittance facilities scheme, it grants free remittance facilities in the "Reverse direction". That is, in order to encourage the flow funds from urban to rural areas, the Bank permits co-operative central financing agencies to effect free remittance of funds once a week to their upcountry branches. Remittance facilities granted under both the schemes have been increasing quite rapidly.

Remittance Facilities Extended by the State Bank to Co-operative Institutions(1)

Co-operative year, July to June (In crores of rupees)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Under the Reserve Bank of India Remittance Facilities Scheme</td>
<td>54.4</td>
<td>68.5</td>
<td>94.0</td>
<td>123.6</td>
<td>131.7</td>
</tr>
<tr>
<td>2. Under the State Bank of India's own scheme</td>
<td>29.9</td>
<td>51.9</td>
<td>65.9</td>
<td>102.7</td>
<td>92.0</td>
</tr>
<tr>
<td>3. Total</td>
<td>84.3</td>
<td>120.4</td>
<td>159.9</td>
<td>226.3</td>
<td>223.7</td>
</tr>
</tbody>
</table>

(b) Finance for marketing and processing co-operative societies

Since 1957, the Bank has been financing the co-operative marketing and processing societies. Advances are given against pledge or hypothecation or other suitable security. Since 1961, the Bank has been providing clean accommodation to co-operative marketing and processing societies and medium-term credit to processing and industrial co-operatives. The Bank provides...

(1) Source: State Bank of India Annual Reports
direct finance to marketing and processing societies where the co-operative central financing agencies are unable to render prompt and adequate finance. The State Bank takes into account the special needs and modes of operation of the societies, so as to give them effective financial assistance. Branch agents have been asked to keep themselves in close touch with the activities of the co-operatives and to extend them an attitude of positive helpfulness. Officials of the Bank have also been permitted, whenever necessary to be nominated as directors on the boards of management of district or central co-operative banks. With a view to speeding up the progress of the scheme, every opportunity was availed of for establishing contacts with State Governments, Registrars of Co-operative societies and Apex Co-operative Banks. Four Circle Co-ordination Committees have been set up at the Local Head Offices. These have helped the Bank in establishing closer contacts with the official and non-official co-operators concerned with the Bank's scheme. The volume of outstanding loans in respect of marketing and processing co-operatives, (excluding co-operative sugar factories) was about ₹ 41 lakhs in June 1960. It increased to ₹ 53 lakhs in June 1961 but declined to ₹ 41 lakhs in 1962.

The Bank also made considerable accommodations to co-operative sugar factories. Co-operative sugar factories are offered certain special facilities among processing co-operatives. These include provision of interim accommodation by way of clean loans on the guarantee of the State Government concerned pending the disbursement to them of loans granted by the Industrial Finance Corporation of India, advances, against the pledge of sugar stocks, provision of clean credit facilities for limited amounts for meeting working capital requirements etc. The volume of outstanding loans and advances granted to them by the State Bank increased from ₹ 247 lakhs at the end of June 1960 to ₹ 449 lakhs by the end of June 1962.

(c) Finance for Land Mortgage Banks

The Bank helps the development of land mortgage banks by:
(1) subscribing to the debentures issued by co-operative central land mortgage banks; (2) Granting advances against the security of such debentures; (3) providing interim financial accommodation to co-operative central land mortgage banks against Government guarantee in order to help them carry on their normal loan business pending the raising of funds through flotations of debentures. Outstanding loans and advances to co-operative central land mortgage banks increased from ₹12 lakhs in June 1960 to ₹53 lakhs in June 1962.

(d) Warehousing finance

The Bank has been closely associated with the scheme of warehousing development. It has been trying to establish new branches as far as possible at the centres where warehouses of the Central Warehousing Corporation or State Warehousing Corporation are set up. The bank's officers have been permitted to serve on the advisory committees for warehouses. The Bank subscribed to the share capital of Central Warehousing Corporation to the fullest extent indicated in the Agricultural Produce (Development and Warehousing) Corporation Act, 1936. The Bank also evolved a simplified procedure for facilitating the grant of advances against the security of warehouse receipts for the goods deposited in the licensed warehouses. Outstanding advances granted by the Bank against the security of warehouse receipts increased from ₹121 lakhs at the end of June 1960 to ₹279 lakhs at the end of June 1962.

In June 1960, following the recommendations of the Working Group on Industrial Corporatives and the Government of India's resolution thereon, the Bank decided to finance, industrial co-operatives on certain terms and conditions. It granted advances to a few Industrial Co-operatives under these arrangements.

Thus credit facilities provided by the State Bank to the rural sector
have been steadily increasing. In the words of the Chairman of the State Bank of India, most of the doubts and misgivings initially entertained in this regard have proved to be false and it has been possible to make some arrangements for the Reserve Bank of India, the State Bank of India and the corporate financing agencies to act in a coordinated and harmonious manner.

The increase in the total volume of loans and advances to cooperative institutions by the State Bank of India will be evident from the following table:

<table>
<thead>
<tr>
<th>Loans and Advances outstanding to Co-operative Institutions</th>
<th>(Rupees in crores)</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>(As at the end of June)</td>
<td></td>
<td>---</td>
</tr>
<tr>
<td>State Bank of India Total</td>
<td></td>
<td>---</td>
</tr>
<tr>
<td>1960</td>
<td>4.85</td>
<td>6.67</td>
</tr>
</tbody>
</table>

Source: Annual Reports of the Central Board of Directors, State Bank of India.

The Subsidiary Banks

The All India Rural Credit Survey Committee had recommended the integration of the ten State-associated Banks with the Imperial Bank of India. These were the Bank of Baroda, Bank of Rajasthan, Bank of Bikaner, Bank of Jaipur, Bank of Saurashtra, Bank of Patiala, Bank of Mysore, Bank of Indore, Travancore Bank and Hyderabad State Bank. The State Bank of India Act differed from these recommendations in that it provided for the taking up of only the Imperial Bank of India. However, it contained a provision for the future merger of any bank with the State Bank of India on a voluntary basis, if necessary.
Since the passing of the State Bank of India Act steps were taken for the voluntary merger of some of the minor state associated banks with the State Bank of India. Negotiations were started with some major state associated banks for their being constituted as subsidiaries of the State Bank of India. The Bank of Bikaner, the Bank of Indore, the Bank of Jaipur, the Bank of Mysore and the Travancore Bank voluntarily agreed to join the scheme. The Reserve Bank of India and the Governments of the Punjab and Bombay also agreed, as the respective owners, to constituting the State Bank of Hyderabad, the Bank of Patiala and the State Bank of Saurashtra as subsidiaries of the State Bank of India. To give effect to these agreements, the State Bank of India (subsidiary Banks) Act was passed in 1959.

By constituting these Banks as subsidiaries of the State Bank, instead of securing their complete merger, the advantages arising out of the association of local interests in the affairs of the Banks were sought to be maintained.

The State Bank of India will always be a majority holder of the share capital of these subsidiaries except for the three completely Government owned banks - viz. the Bank of Baroda, Bank of Rajasthan and the State Bank of Hyderabad - whose entire share capital was to be held by the State Bank of India. The process of integration was completed by the end of 1960. The State Bank may give directions and instructions to a subsidiary banks regarding the conduct of its business. The general superintendence and conduct of a subsidiary bank shall vest in a Board of Directors. The State Bank will choose a majority of the Directors. But the subsidiary banks being autonomous bodies, will continue to maintain their individuality and independence in their day to day operations.

In addition to their ordinary banking business, the subsidiary banks shall act as agents of the State Bank for transacting business on behalf of
Central and State Governments and shall also transact any other business which the Reserve Bank may entrust to the State Bank.

The developmental activities of the State Bank of India were sought to be co-ordinated with that of the State associated banks. Some of the centres selected by the State Bank for opening its branches have been handed over to the respective state associated banks. Under the second branch expansion programme of the State Bank, the State Bank was to open 143 and the subsidiaries were to open 155 branches out of a total of 300. Between October 1959 and December 1961 these banks opened 103 new branches. The following table will give an idea of the volume of financing done by the banks:

Recently, the Reserve Bank has been making half-yearly surveys of all the scheduled banks' advances to co-operative institutions. These figures also have been showing an expansion:

<table>
<thead>
<tr>
<th></th>
<th>December 1960</th>
<th>December 1961</th>
<th>December 1962</th>
<th>December 1963</th>
</tr>
</thead>
<tbody>
<tr>
<td>Scheduled Banks Advances to Co-operative Institutions (1)</td>
<td>33.78</td>
<td>42.05</td>
<td>51.01</td>
<td>59.39</td>
</tr>
</tbody>
</table>

The establishment of the Agricultural Refinance Corporation in 1962 is a significant development so far as commercial bank lending to the agricultural sector is concerned. The Corporation will provide refinance facilities to financial institutions making investments for agricultural development. The scheduled banks have deliberately been included in its membership so that they may be encouraged to take a more constructive interest in agricultural development.

(1) Reserve Bank of India Bulletin, September 1964, P.1165
The business of banking is not confined solely to the supply of credit. The mobilisation of rural savings is an equally important part of it. The Rural Banking Enquiry Committee (1949-50) placed a greater emphasis on this side of the business. According to this committee, the two problems of mobilising savings and of extending credit to the rural areas cannot be treated separately. "The agriculturists" says Prof. D. G. Karve, in his reply to the questionnaire sent by the committee, "when he has money, tends to keep it with himself because he expects to need it later. While keeping it with himself for the most provident intentions, he in many cases succumbs to the temptation of other than provident use. "To encourage an agricultural depositor, it is necessary to assure him of the use of his money when he needs it."(1)

There are many who seriously doubt the ability of commercial banks to raise deposits in the rural areas because of the traditionally small size of the holding and the subsistence character of the agricultural occupation in India. But the belief that the rural areas have no contribution to make to the capital formation of the country ignores certain important facts.(2) First, there are considerable differences in income and wealth among different classes of the rural population. There are, at least, some big and medium cultivators who save something in normal times. Some thriftiness may be evident among the smaller cultivators too. In the absence of suitable financial institutions

(1) Rural Banking Enquiry Committee Report, P. 9.
(2) Rural Banking Enquiry Committee Report, P. 30-43.
all these savings have either been blocked in material assets like, land, livestock or precious metals, or have been employed in commerce or else, fitted away to urban channels through consumption and have not been available for productive investment. The growing volume of rural debt represents partly the savings of these classes. This can be substantiated by the important position occupied by agricultural money lenders among the rural credit agencies - this source supplying about 25% of the total volume of rural credit.

The Reserve Bank of India has sought to make some estimates of the savings in the Indian economy during the years 1951-52 and 1956-57. Provided the assumptions of the Reserve Bank of India are correct, there are indications that the savings of the rural and agricultural sector are positive. The Reserve Bank has prepared several tables showing the saving of the agricultural and rural sectors on the basis of the All India Rural Credit Survey, 1951-52 and the Rural Credit Follow Up Survey, 1956-57. These surveys collected information regarding expenditure incurred for acquiring liquid, financial and physical assets, borrowings from various agencies, repayment of loans and sale of assets by households. On the basis of these data, saving per household can be estimated by deducting from the increase in net assets net borrowing and sale of financial assets. These surveys, however, do not give data regarding non-cultivating landlords and landless agricultural labourers. No estimate of the saving of the agricultural sector can be made on the basis of these data. It is, therefore, assumed that the per household savings of the non-cultivating landlords would

be equal to the per household saving excluding repayments and borrowings, of cultivators. It is also assumed that the per household saving of the landless agricultural labourers is nil. These estimates show that there is some positive saving in the rural areas, however small.

Another factor to be taken into account is the large extent of rural indebtedness. This is not necessarily a sign of weakness. Rather, it indicates the more commercialised nature of the economy and the greater credit worthiness of the cultivator. Thus, the All India Rural credit survey and the subsequent Follow Up Surveys show that the bigger share of the debts goes to the big and large cultivators, rather than to the medium and small cultivators.

Still one more indicator of the capacity to save of the rural population is the increase in agricultural income over a period. Ever since the fifties, the volume of agricultural income at current prices has been increasing. It is true that the increase in agricultural income has not been keeping pace with the increase in total national income.

(1) Reserve Bank of India Bulletin, March 1960, P.320, Table 15.
industrial income. Still, the rise in agricultural income which will be evident from the following table indicates an increase in the capacity to save, however small:

Table

<table>
<thead>
<tr>
<th>National Income by Industrial Origin (1)</th>
</tr>
</thead>
<tbody>
<tr>
<td>(In rupees abja at current prices)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Total of agriculture</th>
</tr>
</thead>
<tbody>
<tr>
<td>----------</td>
</tr>
<tr>
<td>43.1</td>
</tr>
</tbody>
</table>

Finally one has to take into account the manner in which the increased incomes are being used. In a memorandum sent to the Rural Banking Enquiry Committee, Prof. D. G. Karve remarks, "Among the generality of the rural people................. wasteful and extravagant expenditure on non-essentials, such as cheap luxuries, beverages, smoking, travel, entertainments, and drink, ceremonies and marriages etc. have been on the increase and those probably account for a larger part of the incomes obtained by the smaller people in rural areas ............. To some extent, larger incomes are also being utilised to raise consumptions over previous standards". (2)


(2) Rural Banking Enquiry Committee Report, P.41.
The following table gives some indication of the way in which rural incomes are utilised.

**Consumer Expenditures : All India (Rural) (1)**

Pattern of Consumer Expenditure as percentage of Total expenditure in Rural Areas.

<table>
<thead>
<tr>
<th>Items</th>
<th>First Round, July 1949</th>
<th>Fourth Round April to June, 1950</th>
<th>September 1952</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Percentage of total expenditure</td>
<td>(2)</td>
<td>(3)</td>
<td></td>
</tr>
<tr>
<td>Food Total</td>
<td>66.31</td>
<td>63.15</td>
<td></td>
</tr>
<tr>
<td>Pan (betel)</td>
<td>0.30</td>
<td>0.70</td>
<td></td>
</tr>
<tr>
<td>Tobacco</td>
<td>1.79</td>
<td>1.91</td>
<td></td>
</tr>
<tr>
<td>Intoxicants</td>
<td>0.73</td>
<td>0.61</td>
<td></td>
</tr>
<tr>
<td>Fuel &amp; light</td>
<td>3.25</td>
<td>5.41</td>
<td></td>
</tr>
<tr>
<td>Clothing</td>
<td>8.63</td>
<td>7.18</td>
<td></td>
</tr>
<tr>
<td>Education</td>
<td>0.30</td>
<td>0.79</td>
<td></td>
</tr>
<tr>
<td>Medicine</td>
<td>0.90</td>
<td>1.59</td>
<td></td>
</tr>
<tr>
<td>Conveyance</td>
<td>1.30</td>
<td>1.31</td>
<td></td>
</tr>
<tr>
<td>Services</td>
<td>3.62</td>
<td>5.22</td>
<td></td>
</tr>
<tr>
<td>Ceremonials</td>
<td>7.21</td>
<td>5.69</td>
<td></td>
</tr>
<tr>
<td>Rent and Taxes</td>
<td>0.57</td>
<td>1.73</td>
<td></td>
</tr>
</tbody>
</table>

(1) National sample Survey (Issued by the Cabinet Secretariat, Government of India) Fourth Round, April to September, 1952, No.13, Table 2:1, P.4.
According to the estimates of the First Round, 10.58 per cent of the total expenditure was on pan, tobacco, intoxicants and ceremonials. According to the Fourth Round, 8.91 or nearly 9 per cent of the total expenditure was on these four items. Where income is so low that two-thirds of it must be spent upon food, an expenditure of 8 - 9 to 10 per cent on non-essentials must be regarded as very high indeed. There is also no reason to think that there has been a fundamental change in these percentages since 1952.

Banking Facilities in the Rural Areas.

From all considerations, the direct role that could be played by commercial banks is extremely limited. The Rural Credit Survey Committee completely ruled out the possibility of the commercial banks (other than the State Bank) being of any importance in the field of rural credit. But the possibility of indirect help rendered by them is not negligible. For this, a greater penetration into the interior of the economy is required. It is of course inconvenient and unlikely for them to extend their offices beyond the small towns. Nor is it necessary for them to do so. They can be of immense benefit to the rural people from the nearby towns. In the opinion of the Rural Banking Enquiry Committee: "As the expansion of banking facilities to medium sized towns, accessible to a large belt of villages around, and comprising of a mixed population of small traders, agriculturists etc., would be of benefit to the rural areas, even banks having their offices in such areas, but having no direct contacts with the villages would be serving the needs of the rural areas and it should, therefore, be assured that there has been a substantial..."
expansion of banking facilities to those areas." (1) First, banks would maintain close links with the rural life through the medium of big landlords, traders and moneylenders. Secondly, nowadays all classes of cultivators have close connections with nearby towns. They go to the towns at the earliest opportunity of spending their funds. The connections with town life are already quite close among the more affluent sections of cultivators. In so far as their surplus money is not deposited with postal savings banks or co-operative societies, there is a scope for mobilising such funds.

There are, however, serious impediments to the working of commercial banks even in this peripheral zone of the rural economy. Leaving aside the problems which arise from the very nature of the rural occupation itself, there are many others of a permanent character. They will take a long time to remove and would require active state interference. Insufficient means of communication, illiteracy and conservatism of the rural population, their unwillingness to go through the rigidities of the banking business, lower earning capacity and higher operating costs of banks in the semi-urban areas, are some of these problems. Illiteracy and conservatism are problems of banking business all over the country, not simply in the rural areas. To counteract the problem created by the illiteracy of the rural population and their inability to handle pass books, cheque books etc., the Rural Banking Enquiry Committee suggested that banks should arrange for identification of the thumb impressions of their customers by local persons of importance, or should maintain a record of the birth marks of their customers and also use regional languages in their pass books, cheque books etc. All these measures suggest increasing costs.

(1) Rural Banking Enquiry Committee Report, P.25.
and complications, but they may be given a fair trial if the prospective volume of business is going to be large. Educative propaganda about the benefits of banking will be helpful. It is also essential that banks should have close connections with local persons of influence either as director or as employee, so as to create confidence among the villagers. It order that banks should shed the rigidity of their methods of working, and mould them according to the needs of the areas, the branch managers should be given wide discretionary powers. The general tendency of banks in all countries has been in the same direction.

A formidable problem for banks working in the semi-urban areas is the higher operating cost and lower earning capacity. Operating costs are higher because of the non-availability of trained personnel and cheap remittance facilities in these areas. Business in the initial stages is likely to be very uncertain. It, therefore, becomes more difficult to implement the awards of the tribunals in these places. The only remedy lies in some material help from the State to the commercial banks. In the case of the State Bank of India, the initial losses to be incurred in opening branches in the rural and semi-urban areas were to be met out of the Integration and Development Fund. The propriety of opening a similar fund contributed partly by the Reserve Bank and partly by commercial banks may be considered.

The Rural Banking Enquiry Committee recommended that state help should be of a general, rather than of a specific nature and be in the form of indirect stimuli. For, measures of specific assistance, such as direct subsidies or placement of interest-free government deposits would raise the charge of discrimination and they should better not be extended to commercial banks which were purely profit making institutions. Such aids should rather go to co-operative institutions which took up risky, yet
socially necessary enterprises. The indirect stimuli proposed by the Rural Banking Enquiry Committee were (1) facilities for cheap remittance of funds; (2) facilities for conversion and exchange of notes and coin; (3) facilities for safe keeping of funds; (4) Promotion of warehouses. From all these points of view implementation of the recommendations of the All India Rural Credit Survey is of great significance. These recommendations and their taking up by the state merely point to the limits of private commercial banking in the field of rural credit. With state help commercial banks would be of greater use in the future.