CHAPTER I

Historical Developments in Indian Banking as means of evolving a better Social Control with economic justice.
CHAPTER-I

HISTORICAL DEVELOPMENTS IN INDIAN BANKING
AS MEANS OF EVOLVING A BETTER SOCIAL
CONTROL WITH ECONOMIC JUSTICE.

INTRODUCTION:

The Indian Government did not awake the need of banks in India till 1908. The need of banks, to issue notes and exchange of funds etc. is taken place with India got out of barter system. In the year 1840 and 1943 respectively two Presidency Banks viz. Bank of Bombay and Bank of Madras were established. In the year 1860 the principle of limited liability was first applied to joint stock companies doing banking business and the lift was given to increase banking business in India. But the rate of growth was not maintained as expected due to crisis of the year 1862-65. The Swadeshi Movement took place in the year 1906 to 1913 by Mahatma Gandhi which prompted Indians to start many institutions and number of joint stock banks increased remarkably during boom period(1906-1913) viz. the Peoples Bank of India Ltd., the Bank of India Ltd., the Central Bank of India Ltd., the Indian Bank Ltd., and the Bank of Baroda Ltd. The working of all these banks came to an end in the year 1920 when the Imperial Bank of India Act of 1920 passed and all these Presidency Banks were amalgamated into the Imperial Bank of India.(Now the State Bank of India.)

The question of issue of notes and control over the currency of the country remained unsolved after passing the Imperial Bank of India Act, 1920. In the year 1935 the Reserve Bank of India was established and took over all these functions of Imperial Bank. In the year 1955 a specified Act was
passed known as The State Bank of India Act, 1955 to take over the business of the Imperial Bank and the Reserve Bank of India be treated as Central banking institution of the country. The Reserve Bank of India played a significant role both during the war and post war years, in helping the economy of country. Another development in the history of the banking system was that implementation of the Banking Regulation Act, 1949 under which vide statutory power of control and regulate the activities of the banking institutions.

**PROGRESS IN BANKING BUSINESS:**

Till 1969, the bulk of banking business was carried on joint by the stock companies although there exist some private sector banks, indigenous bankers and banks formed under special acts. The deposits in India exceeded to Rs.7000 crores as against the Rs.850 crores in 1951. Since the attainment of independence Government has taken active steps by starting institutions viz. I. F. C., S. F. C., I. C. I.C.I., N. I. D. C. and ID BI to render financial assistance to Indian industries large medium and these in small scale sectors. Co-operative Banks have also played a limited role in the Banking system of the country. All India Rural Credit Surevey was undertaken and implemented the recommendation regarding credit gaps and extend credit to rural areas. The co-operative banks have also made an impressive growth during last decades. The number of bank offices has shown considerable increase from 4151 to the end of 1951, to 11,184 upto the end of 1970 and total deposits have increased over six times during that period.
The figures of credit extended by scheduled commercial banks was not so satisfactory and progressive. The following table is showing percentage of distribution of various sectors comparatively.

<table>
<thead>
<tr>
<th>Sector</th>
<th>Percentage 1951</th>
<th>Distribution 1967</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Industry</td>
<td>34</td>
<td>65</td>
</tr>
<tr>
<td>2. Commerce</td>
<td>36</td>
<td>19</td>
</tr>
<tr>
<td>3. Financial</td>
<td>13</td>
<td>4</td>
</tr>
<tr>
<td>4. Personal</td>
<td>7</td>
<td>4</td>
</tr>
<tr>
<td>5. Agriculture</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>6. Others</td>
<td>8/100</td>
<td>6/100</td>
</tr>
</tbody>
</table>

(Source: "Banking Law and Practice in India" by M. L. TANNAN)

The above figures show that uneven distribution of credit and major portion of funds diverted towards industries. Indian economy is predominantly agriculture. More than half of the national income is derived from agriculture. This credit gap challenged the economic planning of the Government and there were complaints that the banks are extending their credits only to the large and medium scale industries, big and established business houses. The other priority/neglected sectors viz. agriculture, retail traders, transport operators, small businessmen professionals and self employed persons etc., were not receiving the required share in increased funds from banks. In addition to that, it was alleged that the directors who were mostly industrialists, big businessmen were diverting bank funds towards their own institutions or firms.
Economic development in our country has not been even in spite of planning being accepted as an instrument of economic change. This has been reflected in regional imbalances in economic development. This problem was discussed by the National Credit Council constituted as part of social control over commercial banks to study the credit needs of various sectors of economy so as to deploy and allocate credit such as would promote economic growth specially in the backward areas of the country. National Credit Council set up study group to study this problem and make appropriate recommendations.

The study group named as "Organisational Framework for the implementation of social objectives" under the chairmanship of Dr. Gadgil has been set up and first meeting of the group was held on 24th July, 1968. The group has to study mainly the task of identifying major credit gaps and has made suggestions for action to meet the problem. The Indian banking system has made significant progress by expanding its territorial and functional coverage and yet the uneveness of spread of institutional credit facilities to different areas of the country. In view of the planned efforts for economical development of the country, it is necessary to have institution which can subserve the social and economic objectives of planning. Government's accepted policy that the benefits of economic development must accrue more and more to the relatively less privileged classes of the society and that there should be a progressive reduction in the concentration of income, wealth and economic power. In this context, the main social objective of banking and credit would appear to be that of more evently spreading institutional credit over unbanked and
under-banked areas and ensuring that neglected sectors and the small borrowers who have to depend upon non-institutional credit - also get adequate credit reasonable terms from banks. On July, 12, 1969, the Group had completed its delibrations and finalised its approach to the problems of meeting the credit gaps.

THE SARAIYA COMMISSION:

In 1931 the Indian Central Banking Enquiry Committee had made detailed study of the working and problems of banking in India. But it is difficult to recommend a Committee due to repeated changes and developments which have taken place in the banking system in India. Since the termination of second world war and independence reflected necessary changes in the political ideology with a view "to take close look at the banking system". A commission under the chairmanship of Mr. R. G. Saraiya was appointed in 1969.

Very wide scope was given to the reference made by commission, which was in the relation to the examination of the structure and the operation not only of the commercial banks but also of the co-operative and financial institutions as well as financial activities. These, further required the commission to examine the coverage, functions, methods, procedures, organisation, cost, planning, management opportunities for research in the banking system and make recommendations to the Government on all above aspects and suggest how the system can be made efficient instrument of economic policy and the manner it can be work in co-ordination with Government policies "for national Economic Development".
The recommendations cover all aspects expected by the Government one of the main proposals relates to the reconstruction of the banking system. Commission recommended that 22 public sector banks including State Bank of India and its seven subsidiaries 14 nationalised banks will be reorganised into 8 or 9 banks. But this proposal is not accepted because it is considered that retention of the identity of individual banks has kept up spirit of healthy competition which has been helpful in development of banking on sound line.

The report of the Commission has been studied by the Government and has taken decision on some of the recommendations made by the Commission which are as follows:-

The Government has accepted almost all recommendations made by the Commission in regard to the banks operating methods and procedures so as to achieve simplification of credit procedure and recommendation of internal control system and organisation management in order to improve functional and operational efficiency. The Government has taken decision to amend some of statutes governing banks in view of the recommendations. The Government has not accepted the recommendations of the Commission for establishing a separate merchant banking institution and setting up specialised institutions for consumer credit.

LEAD BANK SCHEME:

Economic development in our country has been resulted into uneven distribution of economic resources and this has been reflected in regional imbalances in economic development. The question of how the bank could contribute balanced regional economic growth was discussed by National Credit Council and set up special study group for implementation. The study group
suggested "Area Approach" to be followed by commercial banks to promote economic development of backward areas in the country. As per recommendations of the study group, the Reserve Bank constituted a Committee under the chairmanship of Mr. Nariman in the year 1969. The Committee suggested not only commercial banks but other financial institutions, Government agencies, Co-operative Banks also to participate in progress of economic development.

The scheme suggested by Mr. Nariman is known as Lead Bank Scheme under which the commercial banks are to play vital role in the process of economic development especially in the backward areas. Under the scheme the country was divided into 336 districts and they were distributed among major public sector banks to play the "Lead Role".

SOCIAL CONTROL ON BANKS:

On 14-12-1967, the Deputy Prime Minister and Minister of finance made statement in 'Lok-Sabha' declaring the view of Government and how it proposed to impose the social control. Two main steps were undertaken - 1) Setting up of a National Credit Council (shortly known as N.C.C.), 2) introducing Legislative Controls by amending the Banking Regulation Act.

National Credit Council was set up under Resolution of Government No.P.4(43)BC/67 dated 22-12-1967 and its functions are broadly 1) to assess the demand for bank credit from various sectors of the economy, ii) to determine priorities for grant of loans and advances and for investment having regard to the availability of resources and requirements of priority sectors in particular agriculture, small scale industries and exports,
iii) to co-ordinate leading and investment policies as between commercial banks, co-operative banks and other specialised agencies to ensure optimum and efficient use of the overall resources.

The second step towards social control is the passing of Act 58 of 1968 which introduced radical amendments in certain provision of the "Banking Regulation Act" to provide for the extension of "Social Control over Banks".

The additional controls and restrictions are imposed by amending Act can be broadly stated as follows:-

1) The Board of Directors of banking must consist of that the directors having special knowledge and practical experience in respect of certain specified subjects related to banking are in majority over the directors (Section 10 A of the Act).

2) Management of the affairs of a banking company by whole time chairman who has special knowledge of banking and practical experience in the working of a bank or financial, economic or business administration. (Section 10 B of the Act).

3) Restrictions on loans and advances by a banking company to its directors or to the company or firm in which a director is substantially interested or to an individual for whom a director is a guarantor. (Section 20 of the Act.)

4) Additional power conferred on Reserve Bank of India to enforce and supervise the social control. (Section 30, 35 B, 36(i)(d) and 47 A of the Act.)

5) Punishment for (a) obstructing any person from lawfully entering or leaving a bank (b) holding demonstration within bank, (c) acting to undermine 'depositors' confidence in a bank. (Section 36 A D of the Act).
6) Special powers of Central Government to acquire undertakings of banking company when it is satisfied on a report from the Reserve Bank of India that the Banking Company has committed certain defaults and that it is necessary to do so.

From February 1969, the Government imposed 'Social Control' on banks by introducing certain provisions in the Act. It imposed severe restrictions on the composition of the Board of Directors and internal management and administration of Banking companies. The expression social control in relation to the banks and banking came into vogue since December, 1967. At that time, there were complaints that the banks are extending their credits only to the selected sectors of the economy. The Government, however, thought that it would be feasible to allow the commercial banks to function in the private sector but to impose such, further controls and restrictions upon them as would determine priorities for lending and investment, evolve appropriate guidelines for management. It would be ensured that there were no opportunity in the hands of bank management and directors. These imposition of additional control and restrictions was termed as social control.

NATIONALISATION OF 14 MAJOR BANKS:

Within 6 months of the imposition of social control on banks, with effect from 19-7-1969, the Banking Companies (Acquisition and Transfer of undertaking) Act, 1970 came into force. It nationalised the major 14 Indian Banks by providing that the whole of undertakings of those Banks, shall be taken over by and become vested in 14 corresponding new corporate bodies under the Act.