CHAPTER - III

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Commercial banks perform a number of inter-related functions, all of which are vitally important. A clear and precise understanding of the role of commercial banks in the national economy is absolutely essential. The commercial banks bring into being the most important ingredient of the money supply namely demand deposits, through the creation of credit in the form of loans and advances and investments. They are the custodians of the community's money and at the same time the suppliers of its liquidity. The banks provide an easy and quick payment mechanism primarily through cheques but also through drafts, coupons, money transfers by letter and telegraph etc. Along with other financial institutions, the banks actively participate in mobilising savings and investing them. All these functions, custody of money, supply of liquidity, saving and investment are all inter-related.

The deposits that a bank creates never remains with it. The money the bank can invest or lend is its excess of cash and bank balances over required reserves and minimum cash requirements. Bank loans and investments may finance production, distribution, investment, consumption and the needs of the Government. Credit enables goods to move through the channels of trade, people to acquire homes, ordinary people to buy durable goods, the nation to finance its defence and economic development, entrepreneurs to build factories and
very many other useful purposes. Without credit, business, trade and commerce would be difficult. In supplying credit to farmers, manufacturers and individuals, the commercial banks bridges the time lag between production and consumption. By lending and investing the banks provide money immediately in consideration of either assets or efforts which have a future money value. A sound extension of credit is one that will be repaid in the normal course of business from the liquidation of the transaction financed or by income generated by it. Bank credit is temporary; it calls for repayment, not forced liquidation.

A depositor puts his money in a bank for a variety of reasons. He may do it to use the payment facilities provided by the banks. Or he may deposit the funds as a reservoir of purchasing power for future, known or anticipated future expenditures. Lastly one may deposit funds in banks for true or real savings purposes. For the former type of deposits there is little competition, whereas for the latter two varieties the competition among banks is keen.

Another function which commercial banks shares with a number of other financial institutions is that of accumulating and investing the savings fund. Through the savings process purchasing power is diverted from current consumption into the market for capital goods. As savings are invested in plant and equipment, in houses, or, through Government in schools and roads and exploration of space, the productive capacity and therefore the real wealth of the economy is increased. In this vital process commercial banks play two roles; they
themselves help to channel savings into productive uses and, through their short-term lending, they supplement or provide liquidity to other savings institutions and investment media.

Apart from the above mentioned essential functions, commercial banks render many miscellaneous services to the public. Most banks operate safe deposit facilities and hold securities and other valuables in safe-keeping for their customers. Businessmen find the financial guidance and advice they receive from their banks to be one of the most important of banking services. Exporters and importers particularly rely very much on the advice of their bankers. All too often one hears the public relations officer of a bank make the statement that 'all we have to sell is service'. Actually what banks have to sell is credit, which is another name for liquidity or purchasing power. Service is not a product but a price; the cost of a bank's deposits which are, in turn, the raw material of its credit-creating business.

NATIONALISATION

The socio-economic importance of banks is evident even to a layman. The banks play a crucial role in the economic development of the country. Particularly in developing countries like India they hold the key to progress. A bank is the heart of the economic organism of a society. It pumps in and out money, from and to respectively, the remote periphery of a social order. Like human organism and the function of the heart in relation to it, the economic activities and the banking operation is intricate, delicate and full
of complexities. The banking system of a country is not an imposition, it is a growth. It has, therefore, an organic relation with the pattern of economic activities of the society we live in.

Banks, being social institutions undertaking economic functions, have to be looked at from different angles, social, economic and political. The role that banks play in the socio-economic advancement of the country gives a political tinge to the problem of objectives, ownership and management of commercial banks. There are two diametrically opposing view points, one of which maintain that banks will serve the country and the community better if they are in the public sector.

In this connection it would not be out of place to discuss in some detail the various arguments put forth by academicians, bankers, industrialists, political leaders and workers for and against nationalisation of banks.

ARGUMENTS IN FAVOUR OF NATIONALISATION:

1. The objectives and priorities of our five year plans were totally disregarded and neglected by the private-sector commercial banks. Bank credit, instead of using it for the fulfilment of our objectives, were being directed into channels which had the least or no priority. "Private control of commercial banks in a planned economy is an anachronism which

has been an obstacle to the achievement of plan objectives in India.\textsuperscript{2} The same Report further adds that private sector commercial banks have "diverted bank credit into channels which were contrary to the laid-down priorities in the plan." The contention was that after nationalisation the huge amount of profits which these banks make, would be available for financing the five year plans. The profits diverted from the private hands to the public sector would be readily available for fulfilling the cherished plan objectives.

2. Some of the banks in the private sector used to flout and ignore the directions issued to them from time to time by the Reserve Bank of India under the provisions of the Banking Regulation Act. For instance, in 1955-56, the banks violated the directions issued by the Reserve Bank of India regarding advances against food grains which ultimately lead to a rise in the prices of food grains.

3. The commercial banks encouraged unsocial and antisocial activities like hoarding and speculation. Sometimes they themselves indulged in such activities. In this connection Sabarwal quoted the example of Vivian Bose Commission in which some banks were directly involved in the Dalmia Jain affairs\textsuperscript{3}.

Bank credit plays a very vital role in the maintenance of price stability. If it is given by the bank directors to their

\textsuperscript{2} Four Economists' Report (Banking Institutions and the Indian Economy - A critical review) Headed by Dr. S.K. Goyal, Lucknow University, p. 20

friends and close business associates without due regard to the interest of the community of large it is definitely a deplorable, unsocial act. By encouraging hoarding and speculation it leads to inflation. Currency and bank credit differ in form, but in substance, both are instruments of exchange. Credit creation by banks is an important source of money supply and as such it should created in a judicious manner keeping in view the interests of the community as a whole. In their blind pursuit of maximum profit very often banks forget the social objectives.

4. Yet another criticism against the private sector banks was that they completely neglected and paid the least attention to vital and important sectors of our economy like agriculture, small-scale and cottage industries, retail trade, etc. The lion's share of the banks' resources was eaten up by the big, organised industries. According to a survey of the Reserve Bank of India in 1961-62, the share of commercial banks in total agricultural credit was only 0.4 percent. While agriculture contributed about 50 percent of the total national product, the commercial banks supplied only 2.1 percent finance to the same in 1967. Same was the fate of small-scale industries too. While small-scale industries contributed 40 percent of the total Indian industrial production, it could secure only 6.6 percent of its total credit from the commercial banks in 1967. Similarly, retail trade, a very essential service in a vast agricultural country like India, was also

4. Deshpande, S.A., Ibid., p. 27.
completely neglected by the commercial banks in the matter of meeting their credit needs. It could obtain a meagre 2 percent of their entire credit needs at the end of March, 1967. This type of deplorable state of affairs can only be improved by nationalisation whereby necessary resources can be made available to these vital sectors.

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5. Rightly or wrongly the commercial banks were held responsible for the existing regional disparities in the country. According to the Report of the Four Economists, banking offices were concentrated in a few states and banking activity was mainly confined to urban centres. Looked at from the point of view of branch expansion as well as advancing of credit some states got favoured treatment from the banks at the cost of other less developed states and regions. For instance, "from the area point of view, the regional disparity in India is striking. The area covered per office varies from 6153.6 sq. miles in Jammu and Kashmir, 1075.0 sq. miles in Orissa to 58.1 sq. miles in Kerala. Population per office varies from state to state indicating regional disparities.

On the basis of region-wise distribution of Indian commercial banks, the concentration is visible in the regions of Mysore, Maharashtra, Madras, West Bengal and Kerala. The new trend of branch expansion is concentrated in the regions of Maharashtra, Gujarat and Madras which are fairly advanced.

The four cities, namely, Bombay, Calcutta, Delhi and Madras account for major slice in deposits. Again the major share of per capita advances is sliced by developed regions like Maharashtra, West Bengal, Gujarat and Madras leaving very small shares to regions like Orissa, Jammu and Kashmir, Assam, Bihar, Rajasthan, Madhya Pradesh, Mysore, Uttar Pradesh, Punjab and Haryana." 6 "It is a fact that the distribution of banking offices is faulty and there is an over concentration of banking offices in the big industrial and commercial centres while there is a complete neglect of the banking facilities in the rural areas." 7

6. Another criticism against the management of banking institution was that they directly helped concentration of wealth in the hands of a few people. This is definitely against the declared objective of the Government to bring about a socialistic pattern of society. For example in a country like India, with the second largest population in the world, it is fantastic to visualise, that two thirds of total advances of the banking system goes just to 650 accounts in the country. "It is to be seen whether the position can be remedied by anti-trust laws or whether the state will have to be directly involved in the operations of these power bodies." 8 Similarly banks are controlled by

one or the other big industrial houses. "Almost every Industrial House in this country controls one or the other bank. Take the case of biggest commercial banks,

Central Bank of India Ltd. - Controlled by Tata
Bank of India Ltd - Khatau, Mafatlal Group
Punjab National Bank Ltd. - Dalmia Jain Group
Bank of Baroda - Walchand Hirachand Group
United Commercial Bank Ltd. - Birla Group.

To cite a few instances of small banks,

Hindustan Commercial Bank Ltd. - J.K. Group
Hindustan Mercantile Bank Ltd. - Tata Group

The aforesaid industrialists control in turn a number of industries and almost the entire private sector is owned by a few industrial houses. They are thereby enjoying a position of monopoly in their business."9 A director of a bank is a common director of many other industrial concerns and as such he is able to turn the bank into a power house for his industrial empire. Due to interlocking of directorship in banks and industrial houses huge portion of the entire bank credit was syphoned off the big industrial houses. "Common knowledge and experience clearly show that such influential directors of a bank not only take loans from their own banks but also take advantage of their position to borrow from other banks by way of mutual accommodation of

Appendix B - Statement of the All India Bank Employees Association, Delhi.
one another's companies. The resources of banks are being misused for the benefit of directors and their industrial concerns. The Four Economists' Report, supporting nationalisation, quoted an ex-Governor of the Reserve Bank of India as having said "One of the structural features of Indian banking is this concentration of powers, which in some cases, is enormous in relation to the capital actually employed. From time to time we come across cases in which a family or group has a controlling interest in a bank and it has become a major task of inspection to prevent the existence of this interest in undesirable ways."

7. It was said that the banks were being managed in utter disregard of all sound principles of banking. Although the banks were making large profits disproportionate to the capital invested the management never cared to build up their capital and reserve base. "The ratio of profits of the scheduled banks before tax to paid up capital and reserves went up from 12.2 percent in 1951 to 34.3 percent in 1961 and further to 42.5 percent in 1968, which is quite significant. In other words banks earn Rs. 42 crores yearly. On the contrary the capital base of the banks has been deteriorating. The ratio of paid-up capital and reserves to deposits slipped down from 9.7 percent in 1951 to 4.1 percent in 1961 and further declined to 2.6 percent in 1968. This, notwithstanding the fact that the Reserve Bank had enjoined upon


commercial banks as early as 1961 to aim at a reserve base of at least 6 percent of their deposit liabilities.\textsuperscript{12}

8. Commercial banks in India, despite their long existence and experience have miserably failed in their primary duties of mobilising savings and developing the economy. Sri Ashok Mehta\textsuperscript{13} in an article entitled 'Property rights and Bank Nationalisation' says "Whatever work our banks may have done, the fact remains that our banking has fallen behind other countries. I have a few 1967 figures which show the general pattern of saving. The ratio of bank deposit to G.N.P. in respect of India is 12 percent while it is 67 percent for Japan. Other countries similarly placed as India show a better ratio of deposits to the G.N.P.: In Philippines and Malasia it is 20 percent, in Iran 18 percent and in Pakistan 14 percent. As may be seen the performance of other developing countries is better than India.

The proportion of demand deposit to the total money supply in a country also shows to what extent the economy is developing. In this sphere also India is lagging behind. The proportion of demand deposit to the total money supply in India is only 36 percent while it is 79 percent in Japan - the highest in Asia - 61 percent in Iran, 46 percent in Ceylon and 41 percent in Pakistan." Although they did pioneering

\textsuperscript{12} Narendra Kumar - op. cit., p. 203.

\textsuperscript{13} Ed. Singhvi, L.M. - Bank Nationalisation and the Supreme Court Judgment - Published under the auspices of the Institute of Constitutional and Parliamentary Studies, New Delhi, 1971, pp. 37-38.
work in the field of banking when it comes to the needs and requirements of banking for the growth of the economy not much seems to have been done.

9. Nationalisation of commercial banks is after all not such a novel idea. Even from the ideological point of view some countries that are out and out capitalist, like West Germany, have a major portion of their commercial banks under the State sector. No one need feel elated for having done an act of bravery nor feel apologetic about it. In Italy 90 percent, France 75 to 80 percent and Germany 65 to 70 percent of banks are under the public sector. It is not only developed countries but some of the developing countries also, like Burma, Ceylon and United Arab Republic have nationalised their banks.

10. Last but not the least, the country would benefit immensely by nationalisation. The pace of economic development would definitely be accelerated through increased mobilisation of savings and utilisation of such savings for beneficial and productive purposes.

Bank employees, users of banks and depositors alike stand to gain by such a measure. Apart from better promotion chances and greater job security, the employees' salary and working conditions would improve. Bank users can hope for more efficient service since the employees would be working

with a sense of social responsibility. Similarly the depositors
also would realise that their funds are safe in the hands of
the State. The Ghost of bank failure would no more haunt the
minds of millions and millions of poor depositors.

ARGUMENTS AGAINST NATIONALISATION:

According to the Indian Banks' Association most of
these charges are baseless. They say "These and such other
charges are misconceived and are being made due to lack of
knowledge of banking. One wonders whether these charges are
being made to create confusion in the minds of the public.
The banks are functioning within the framework of Reserve
Bank control and regulation in terms of the Banking Regulation
Act and the Reserve Bank of India Act."\(^{15}\)

It would be quite interesting and educative to see
what the antinationalisationists have to say against the
various charges levelled against them.

1. About the neglect of vital sector like agriculture,
it was contended that agriculture was regarded more or less
a preserve of the co-operative sector. Even the All India
Rural Credit Survey was of the view that "Commercial bank,
not only in India but in most other countries, is not designed
for agricultural finance, whether medium or long-term on the
one hand or short-term on the other. This is the experience
of several countries in which agriculture predominates."\(^ {16}\)

16. All India Rural Credit Survey Report - op. cit., Vol. II,
p. 323.
The Indian Banks' Association says "Three years ago, there were hardly any critics who blamed the banks for not financing agriculture. It is only very recently that banks are being made the scapegoat to cover up the failures elsewhere." Quoting the statement of Sri B. Venkatappiah, Chairman of the State Bank of India at that time "In the matter of credit for production in the rural areas - whether agricultural production or industrial production, and whether short-term credit or medium term credit - our contribution is still small. It is understandably and deliberately so, the main role in this connection being that of co-operative banks, as distinguished, from commercial banks."\(^{17}\) "For a long time the official view regarding the provision of banking facilities to the rural areas has been that extension of banking facilities to the rural sector should be earmarked for the co-operatives and urban banking should be largely left for commercial banks ... Thus the official attitude seems to have been that the State Bank of India and the co-operatives would specialise in rural banking and the private commercial banks would confine their activities to the urban centres."\(^{18}\) Therefore, if the commercial banks did not finance agriculture, it was simply because they were not expected to do so. 

As far as financing of small scale industry is concerned the argument was that it was because of financing by the banks that most of the present big and large scale industries are what they are today. Moreover it is risky to

17. Narendra Kumar, op. cit., p. 223
18. Four Economists' Report, op.cit., p. 60
the bank as well as to the depositors to extend credit facilities when small concerns are not in a position to furnish proper and sufficient securities.

It is evident that vital sectors of the economy were neglected by the banks. Indirectly admitting that agriculture had not received their attention, small industries were helped by them in the past but not now and the small man could not be helped because of his inability to furnish sound and solid securities, these arguments are merely excuses or explanations in justification of their past behaviour.

2. About the charge that directives of the Reserve Bank were flouted or ignored Mr. S.K. Basu 19 opines that they are irrelevant. The Reserve Bank has been armed with ample powers of control and regulation, both supervisory and monetary. If in spite of these extensive powers, it has not been able to check these practices, it should be attributed either to its ineptitude or to its direlection of duty.

3. Similarly with regard to the accusation that banks encouraged and patronized hoarding and speculation which led to inflation, the Indian Banks' Association refutes it by saying "There is no substance in such a fantastic charge. The general and selective credit controls on food grains and other commodities and inspections of the Reserve Bank, regulate the nature and amount of bank loans against specific

commodities. Banks always scrutinize the purpose for which they are lending extremely carefully and do not advance at all for hoarding or speculation."\(^{20}\)

4. Again, the charge that banks never used to care for the fulfillment of the objectives and priorities of the planners it was contended that there was not likely to be much of a change even after nationalisation because the credit requirements of the private sector can not be ignored as they occupy a very important position in the scheme of things. The private sector too has to fulfill its obligations towards plan priorities. As it is about \(\frac{1}{3}\) of the total deposits is already with the State Bank group. Whatever funds are available with the commercial banks, after investing in Government securities and meeting other obligations, are utilized by the banks according to the policies laid down by the Reserve Bank of India.

5. Now for the allegation that regional imbalances are there, that some states and regions are flooded with banks and others starved, the blame for this state of affairs ought to be put at the doors of the Reserve Bank of India and not the private sector banks. The authority to the opening of new branches rests with the Reserve Bank of India. True, the State Bank had opened very many branches in the rural areas, but then they are bound by law to do it, and the losses if any were to be met out of a special fund. - Integration and

\(^{20}\) Narendra Kumar, op. cit., p. 224.
Development Fund. Private commercial banks simply can not be expected to follow the foot-steps of the State Bank. Even where private banks opened new branches they had to close it down due to lack of response from the public. "Instances are galore where the banks opened branches or extended mobile banking services in rural areas and were forced to discontinue them on account of the indifference and non-co-operative attitude of residents of these areas." According to the same author, "banks throughout the world have gone rural when the urban needs (for economic development) have been largely satisfied. Rural areas, every where have been backwaters of civilisation and growth, with a total absence of urge for various facilities including banking. Under such circumstances, it was altogether futile to expect banks to go rural and very much undesirable to force them into untrodden regions without providing adequate socio-economic incentives for the present or future."

6. As for the accusation of having helped concentration of economic power, it is justified on the ground that but for the flow of sufficient funds to big industrial houses, production and the economy as a whole would have suffered. It was in tune with plan priorities that banks extended credit facilities to the large industries. Even public sector banks also had adopted the same policy. Similarly the interlinking of banks and big industrial houses was easily explained. Most of the banks were in fact started...

by one or other of the industrial houses.

8. Apart from all these, nationalisation of banks, far from doing good, would do positive harm to the economy. The first casualty would be efficiency of banking service. Redtapism, delay and injection of politics in the field of banking would be the resultant consequence. A drastic measure like nationalisation may have far reaching effects not only on the national but also on the international plane. It may create fear in the minds of foreign investors and aid giving countries.

From a perusal of the counter arguments by people and interests opposed to nationalisation, it becomes clear that most of the allegations against private banks were factually true. It was only an attempt to explain away admitted facts.

"Contraversy over nationalisation, in fact, dates back to 1949, when the Reserve Bank was nationalised. The movement for nationalisation slowly gathered momentum when different political parties started to discuss the matter and pass resolutions to that effect. 1955-56 is yet another land-mark, when the ruling party nationalised the Imperial Bank of India into the State Bank of India. The net was further widened in the next two or three years by nationalising 8 state-associated banks. Since then the idea of nationalising commercial banks had gathered momentum." 22 After the end of the Bangalore session of the All India Congress Committee dramatic and sudden changes

in the political scene took place. Immediately after the Bangalore session, Smt. Indira Gandhi took over the finance portfolio from Morarji Desai saying "in regard to some basic issues that arise, you entertain strong reservations and have your own views about the direction as well as the pace of change. You have expressed your views clearly in the Working Committee and previously on other occasions. I have given deep thought to this matter and feel that, in all fairness, I should not burden you as Finance Minister, but should take it directly on myself." The ordinance to nationalise 14 Indian commercial banks followed the acceptance of Mr. Morarji Desai's resignation on July 19, 1969.

The then Prime Minister, Mrs. Indira Gandhi, made a statement in Parliament on July 21, 1969 on bank nationalisation.

"An ordinance was promulgated the day before yesterday, nationalising fourteen of the major commercial banks incorporated in India. With your permission, I would like to share with the House the considerations which weighed with the Government in taking this momentous decision and the spirit in which they propose to implement it.

Nearly fifteen years ago, parliament approved that we should set before ourselves the goal of socialist pattern of society. Since then, the Government have taken several measures towards the achievement of this goal. Public ownership and control of the commanding heights of national economy and

of its strategic sectors are essential and important aspects of the new social order which we are trying to build in this country. We regard this as particularly necessary in a poor country which seeks to achieve speedy economic progress, consistent with social justice, in a democratic political system - one which is free from domination of a few and in which opportunities are open to all.

Financial institutions are among the most important levers that any society has at its command, for the achievements of its social and economic objectives. It is in recognition of this fact that we nationalised life insurance business and the then Imperial Bank of India over a decade ago. Since then, we have also set up in the public sector other institutions for the provision of medium or short-term finance to industry and agriculture. The nationalisation of major banks is a significant step in the process of public control over the principal institutions for the mobilisation of people's savings and canalising them towards productive purposes.

After serious difficulties which we have had a encounter in recent years, our economy is once again poised for fresh growth and development. There has been a notable break through on the agricultural front, technologically and otherwise. The increase in our exports has been impressive. There has been substantial progress in the matter of power supply and the development of transport as also the availability of trained manpower. Our industrial base has been
strengthened and diversified. It is in this context that we launched the Fourth Plan earlier this year with confidence and determination.

The question which has been engaging our attention for sometime is how best to impart an element of dynamism and new vigour into the process of our development so that the target of the Fourth Plan, in the public and private sectors, can not only be fulfilled but, if possible, exceeded. Our major concern has been to accelerate the tempo of investment and production so as to improve living standards and increase employment opportunities, consistent with our determination to achieve self-reliance. It is necessary to mobilise the savings of the people to the largest extent possible and to utilise them for productive purposes in accordance with our plans and priorities. Government believe that public ownership of major banks, for which there has been widespread public support, will help in the most effective mobilisation and development of national resources so that our objectives can be realised with a greater degree of assurance.

The ordinance promulgated by the Government provides for the nationalisation of all scheduled banks, incorporated in India, which had minimum deposits of not less than Rs. 50 crores at the end of June last. The fourteen banks in this category, together with the State Bank of India and its subsidiaries which already operate under public ownership, account for more than 85 percent of bank deposits in this country. The House will appreciate that in view of the very
nature of the measure, and also to forestall any possibility of manipulations which may not be in the public interest, it was essential to make a swift and sudden move which could only be achieved through an ordinance. The fact that speculation about Government's intentions had assumed an acute phase in the last few days rendered it all the more necessary to act without any further loss of time, and in anticipation of the approval of parliament which will be sought through a Bill which Government propose to bring during the current session.

So far as foreign banks are concerned, they provide by and large, business of a specialised nature such as facilitating foreign trade and tourism. The operation of banks of one country in another, subject to the laws of the land, is mainly for such purposes and is part of an international facility. Our Indian banks also maintain their branches in many countries. It has been Government's general policy to confine the opening of new branches of foreign banks to major port towns, where their specialised services are needed. Having regard to all these factors, Government have decided to exclude branches of foreign banks incorporated outside India from the purview of the ordinance.

As I stated the other day, this is not the beginning of a new era of nationalisation. Whatever the pattern of the economy, it is widely recognised that the operations of the banking system should be informed by a larger social purpose and should be subject to close public regulation. Government have come to the conclusion that the desired regulation and
the rate of progress consistent with the urgency of our problems could be secured only through nationalisation.

I should like to reiterate my assurance that even after nationalisation, the legitimate credit needs of private industry and trade, big or small, will be met. Indeed it shall be our endeavour to ensure that the needs of productive sectors of the economy and in particular those of farmers, small scale industrialists and self-employed professional groups are met in an increasing measure. It will be one of the positive objectives of nationalised banks to actively foster the growth of new and progressive entrepreneurs, and to create fresh opportunities for hitherto neglected and backward areas in different parts of the country.

The banks will now be better placed to serve the farmer and to promote agricultural production and rural development generally. Public ownership will also help curb the use of bank credit for speculative and other unproductive purpose. By severing the link between the major banks and the bigger industrial groups which have so far controlled them, Government believe that the step they have taken will also bring about the right atmosphere for the development of adequate professional management in the banking field. Government attach the utmost importance to modern managerial techniques and practices.

The monies which depositors entrust to the banks are in the nature of a sacred trust. The interests of the
depositors of the banks which have been nationalised will not only continue to be fully safeguarded but will now have the backing of the State itself. I should also make it clear that the emphasis on priority areas, new entrepreneurs and relatively backward areas will not be at the expense of considerations of economic viability. Only thus can we fulfill our obligations to those who have entrusted their savings to us for the benefit of the community. But economic viability can still admit of much greater resourcefulness in lending to priority areas than has been the case so far. The general public already has the experience of the State Bank to show how public purpose and security, as well as good return to depositors, can be combined.

The ordinance has also provided for adequate protection of the interests of the employees of the banks concerned. They have now become employees of a publicly owned and socially responsible banking system. This also places on them special responsibility towards the community. The success of the programme of nationalisation will, in a large measure, depend upon the efficiency, the devotion and the dedication with which they perform their tasks and the courtesy and the consideration with which they treat the constituents of the bank. I hope that all individual employees of these banks and their associations will now help in the successful implementation of the step which has been taken.

The ordinance provides for a scheme of fair compensation for the takeover in accordance with a formula which parliament approved recently, while enacting the Banking Law
(Amendment) Act, 1968. The ordinance provides that compensation will be payable in the form of Government securities.

In order to cause the least possible dislocation in the working of the banks covered by the ordinance and to avoid inconvenience to the public, it is proposed for the present to retain the identity of each bank in the form of a new corporation. The chief executive of each bank is the custodian of the unit concerned on behalf of the Central Government, and will be subject to its control and direction. The old board of directors in each case stands dissolved and the ordinance vests the Government with the power to set up advisory boards in their place. These are interim measures. Changes in the structure of management may also be necessary; these will be undertaken after the most careful consideration. The ordinance provides for such changes to be made.

As in other matters of policy Government have been guided in taking the present decision entirely by national interests and the needs and aspirations of the people. The establishment of a socialist society is one of our declared goals but we have not been guided by any doctrinaire considerations. Our sole concern has been to accelerate development and thus make a significant impact on the problems of poverty and unemployment and to bring about progressive reduction of disparities between the rich and the poor sections of our people, and between the relatively advanced and backward areas of our country. I realise the test of the decision is in its effective implementation. Government are determined to
take all possible steps to make this measure a success.

I should like to take this opportunity, Sir, to appeal to all sections of this House to extend their valuable cooperation in the purposeful implementation of this important measure. 24

The important objectives of bank nationalisation may now be enumerated. Firstly the Government wanted to remove the control by a few. Banks facilitated concentration of economic power and creation of industrial monopolies. Since private ownership leads to the concentration of wealth in a few hands, it perpetuates the existing disparities in society, instead of bridging the gulf between the rich and the poor. Secondly, to provide for adequate credit for agriculture and small industries as well as for exports. Before nationalisation agricultural credit requirements were completely ignored by the commercial banks. True, agriculture has been in the sphere of influence of co-operative banks. In fact intrusion by commercial banks was resented by the co-operative sector. Similarly small industries were also neglected by the banks. Small-scale sector could never hope to compete with big industries in the matter of meeting credit needs. Because of their size, the small-scale sector's capacity to absorb large loans is definitely limited. Some of the banks were owned and managed by big industrialists and big businessmen, who never bothered to meet the credit needs of the small

industries. Bank credit was not distributed in the interests of the country. On the other hand bank finance was made use of for antisocial activities like speculation, hoarding etc. And thirdly, yet another objective of nationalisation was provision of adequate training as well as reasonable terms of service for bank staff so as to give a professional bent to bank management.

As socialism is our basic goal and which is accepted as one of the important tenets of the Indian constitution, nationalisation is definitely in tune with those objectives. Means of production may be owned by the state. Banks being the reservoir of capital they should not be owned and managed according to the whims and fancies of private capitalists. For a planned and co-ordinated progress of the economy banking institutions must be under state control. Private sector banks following independent policies are likely to defeat the policies which the Reserve Bank wants to follow. Public ownership is a necessary concomitant for the development of a healthy banking system conforming to the needs and policies of the Government. Since the aim of the private sector is to maximise profit, they will not venture to extend their services where they are needed most because of the risk of losses. On the other hand, in the case of public sector banks the object is to render service in the interest of the nation as a whole and not to increase their profits. Credit needs of agriculturists and small industrialists and other weaker sections of the population are met by the nationalised banks. The profits the nationalised banks make is also diverted for furthering the
means to achieve the goal of a socialistic pattern of society. Further the interests of innocent depositors are definitely better safeguarded by the public sector banks.

Multiplicity of small banks with inadequate capital structure was one of the glaring defects of our banking structure before the Banking Regulation Act was enacted. Prior to the passing of this Act, a bank could be started with as little a capital as Rs. 50,000. Such banks throw a shadow of suspicion on the entire banking fraternity. They most often followed unsound banking policies. It was a difficult task of inspection for the Reserve Bank to prevent them from following such policies. There were very many other problems also such as lopsided branch expansion leading to over concentration of branches in urban areas to the total neglect of rural parts, unhealthy competition, inadequate share in industrial and agricultural finance, reluctance to widen their field of operation outside the traditional banking functions, lack of trained hands to man responsible positions, steadily declining ratio of paid-up capital and reserves to deposits etc.

Most of the defects enumerated above could have been remedied without resorting to nationalisation. It was not that they were of such a nature which only nationalisation could solve. The powers of the Reserve Bank, particularly after the passing of the Banking Regulation Act, are so wide and comprehensive that by properly and strictly applying them the banks could have been forced to fall in line with the
credit and monetary policies of the Reserve Bank.

However, nationalisation of banks did have far reaching effects on various aspects of banking in India. One important result is the coverage of rural centres by the public sector banks. As Table No. 10 shows, of the 12377 branches added between the date of nationalisation and the end of March 1976, as many as 5598 or 45.2 percent were located at rural centres. On the eve of nationalisation, the bank branches located in rural areas accounted for 22.0 percent of the total. By the end of March, 1976, this proportion had increased to 36.0 percent (Table No. 9). The proportion of bank branches in metropolitan centres and port towns had come down from 20.0 percent on the eve of nationalisation to 16.2 percent at the end of March, 1976.

Table No. 10 intends to show bank group-wise analysis of branch expansion after nationalisation. A comparative picture of the branch expansion programme of various classes of banks is obtained from the above table. The total number of bank offices rose from 8262 in 1969 to 21220 in 1976. Maximum number of branches have been opened by the 14 nationalised banks. After that comes the State Bank of India group. The performance of other scheduled banks also is quite impressive with the opening of 2727 new branches during the period under scrutiny. Their share comes to about 21 percent of the total whereas that of the State Bank of India group comes to near about 27 percent. As far as the opening of branches at unbanked centres is concerned, the total comes to
<table>
<thead>
<tr>
<th></th>
<th>19th July, 1969</th>
<th>31st March, 1976</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Rural</td>
<td>Semi-urban</td>
</tr>
<tr>
<td><strong>State Bank Group</strong></td>
<td>320</td>
<td>1171</td>
</tr>
<tr>
<td><strong>Nationalised Banks</strong></td>
<td>703</td>
<td>1465</td>
</tr>
<tr>
<td><strong>Regional Banks</strong></td>
<td>...</td>
<td>...</td>
</tr>
<tr>
<td><strong>Total Public Sector Banks</strong></td>
<td>1523</td>
<td>2636</td>
</tr>
<tr>
<td><strong>Other Banks</strong></td>
<td>337</td>
<td>708</td>
</tr>
<tr>
<td><strong>All Commercial Banks</strong></td>
<td>1850</td>
<td>3344</td>
</tr>
<tr>
<td><strong>Percentage</strong></td>
<td>22%</td>
<td>40%</td>
</tr>
</tbody>
</table>

Source: Banking Commission op cit page 33.


<table>
<thead>
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</thead>
<tbody>
<tr>
<td>292</td>
<td>2867</td>
<td>205</td>
<td>3072</td>
<td>404</td>
<td>3475</td>
<td>447</td>
<td>3922</td>
<td>1569</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(97)</td>
<td>(65)</td>
<td></td>
<td>(177)</td>
<td></td>
<td></td>
<td>(225)</td>
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<tr>
<td>181</td>
<td>1563</td>
<td>89</td>
<td>1652</td>
<td>88</td>
<td>1739</td>
<td>109</td>
<td>1848</td>
<td>893</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(83)</td>
<td>(31)</td>
<td></td>
<td>(27)</td>
<td></td>
<td></td>
<td>(26)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>926</td>
<td>8103</td>
<td>909</td>
<td>9017</td>
<td>851</td>
<td>9863</td>
<td>1156</td>
<td>11010</td>
<td>4123</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(372)</td>
<td>(318)</td>
<td></td>
<td>(242)</td>
<td></td>
<td></td>
<td>(349)</td>
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<td></td>
<td></td>
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</tr>
<tr>
<td>349</td>
<td>2580</td>
<td>378</td>
<td>2943</td>
<td>444</td>
<td>3385</td>
<td>710</td>
<td>4047</td>
<td>1320</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(132)</td>
<td>(132)</td>
<td></td>
<td>(93)</td>
<td></td>
<td></td>
<td>(172)</td>
<td></td>
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<td></td>
<td>130</td>
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<td>130</td>
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<td>131</td>
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<td>130</td>
<td>130</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1748</td>
<td>15249</td>
<td>1584</td>
<td>16814</td>
<td>1788</td>
<td>18593</td>
<td>2534</td>
<td>21069</td>
<td>8045</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(694)</td>
<td>(546)</td>
<td></td>
<td>(534)</td>
<td></td>
<td></td>
<td>(772)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>8</td>
<td>113</td>
<td>9</td>
<td>122</td>
<td>15</td>
<td>137</td>
<td>20</td>
<td>151</td>
<td>217</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(6)</td>
<td>(2)</td>
<td></td>
<td>(3)</td>
<td></td>
<td></td>
<td>(8)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1762</td>
<td>15362</td>
<td>1593</td>
<td>16366</td>
<td>1803</td>
<td>18730</td>
<td>2554</td>
<td>21220</td>
<td>8262</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(630)</td>
<td>(548)</td>
<td></td>
<td>(537)</td>
<td></td>
<td></td>
<td>(780)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

opened at unbanked centres during the year.

to 1975-76.
5301, of which the State Bank of India, its subsidiaries, Nationalised banks, other scheduled banks and non-scheduled banks have contributed 1164, 467, 2726, 898 and 46 respectively. Although the non-scheduled banks have opened 46 new branches at unbanked centres, their total number of branches as a whole, has gone down from 217 in 1969 to 151 in 1976. On the other hand the branches of foreign banks maintain the same figure 130, both in 1969 as well as in 1976. As is well known they are not allowed to open branches in up country centres. They mainly confine to port towns.

Yet another important and encouraging consequence of bank nationalisation is the absolute as well as percentage increase in the advances of commercial banks particularly to neglected sectors like small-scale industries, agriculture and retail trade. The table below sets out the data relating to sectoral distribution of the commercial banks' advances.
### Table - II

**Sectoral Classification of Scheduled Commercial Banks' Advances**

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Amount % to total</td>
<td>Amount % to total</td>
<td>Amount % to total</td>
<td>Amount % to total</td>
</tr>
<tr>
<td><strong>I Industry</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>a) Large &amp; Medium</td>
<td>2068 67.5</td>
<td>3053 57.6</td>
<td>4555 56.9</td>
<td>4829 59.3</td>
</tr>
<tr>
<td>Industries</td>
<td>1857 60.6</td>
<td>2414 45.5</td>
<td>3550 44.4</td>
<td>3787 46.5</td>
</tr>
<tr>
<td>b) Small Scale Indus.</td>
<td>211 6.9</td>
<td>639 12.1</td>
<td>1005 12.5</td>
<td>1042 12.8</td>
</tr>
<tr>
<td><strong>II Agriculture &amp; Allied Activities</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>a) Direct Finance</td>
<td>67 2.2</td>
<td>360 6.8</td>
<td>709 8.9</td>
<td>830 12.2</td>
</tr>
<tr>
<td>b) Plantations</td>
<td>58 1.9</td>
<td>115 2.2</td>
<td>133 1.7</td>
<td>146 1.8</td>
</tr>
<tr>
<td><strong>III Internal Trade</strong></td>
<td>588 19.2</td>
<td>924 17.4</td>
<td>1396 17.5</td>
<td>1158 14.2</td>
</tr>
<tr>
<td>a) Whole sale Trade of</td>
<td>541 17.7</td>
<td>766 14.4</td>
<td>1180 14.8</td>
<td>929 11.4</td>
</tr>
<tr>
<td>which Food Procurement</td>
<td>109 3.5</td>
<td>542 10.2</td>
<td>523 6.5</td>
<td>209 2.6</td>
</tr>
<tr>
<td>b) Retail Trade</td>
<td>47 1.5</td>
<td>158 3.0</td>
<td>216 2.7</td>
<td>230 2.8</td>
</tr>
<tr>
<td><strong>IV Services</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>V Personal Loans</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>VI All Others</strong></td>
<td>341 11.1</td>
<td>963 18.2</td>
<td>589 7.4</td>
<td>523 6.4</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td>3064 100.0</td>
<td>5300 100.0</td>
<td>7999 100.0</td>
<td>8343 100.0</td>
</tr>
</tbody>
</table>

Source: Banking Commission op cit page 28.
From Table No. 11 it becomes clear how the small-scale industries have benefited after nationalisation. Out of the total advances to industry of Rs. 2068 crores in 1968, small scale industries could obtain only Rs. 211 crores, whereas in 1974 the corresponding figures were Rs. 1042 crores out of a total advance of Rs. 4829 crores. In other words whereas in 1968 large scale and medium industries obtained about 8½ more than small scale industries, in 1974 it was only about 3½ times. Percentage-wise, large scale industries obtained 60.6 percent of the total in 1968 which went down to 46.5 percent in 1974. But in the case of the small-scale sector, the percentage went up from 6.9 percent in 1968 to 12.8 percent in 1974. Similarly, another neglected sector, agriculture obtained Rs. 67 crores or 2.2 percent in 1968, while in 1974 the advances rose to Rs. 830 crores or 10.2 percent. Yet another notable increase is in the case of retail trade. It rose from Rs. 47 crores or 1.5 percent of the total advances in 1968 to 230 crores or 2.8 percent of the total advances in 1974.

Another important field where there has been appreciable change is export credit by the scheduled commercial banks after nationalisation. High priority is being given by the Reserve Bank in the scheme of credit deployment and particularly, provision of export credit by the commercial banks. The Reserve Bank provides liberal refinance facilities to the commercial banks so as to encourage them to enlarge their export credit portfolio. The table below gives an idea of the step-up in the flow of export credit from the scheduled commercial banks:—
Table - 12

Export credit provided by Commercial Banks

<table>
<thead>
<tr>
<th>As at the end of</th>
<th>Amount outstanding (Rs. crores)</th>
</tr>
</thead>
<tbody>
<tr>
<td>March 1970</td>
<td>322</td>
</tr>
<tr>
<td>March 1971</td>
<td>374</td>
</tr>
<tr>
<td>March 1972</td>
<td>449</td>
</tr>
<tr>
<td>March 1973</td>
<td>524</td>
</tr>
<tr>
<td>March 1974</td>
<td>775</td>
</tr>
<tr>
<td>March 1975</td>
<td>714</td>
</tr>
<tr>
<td>March 1976</td>
<td>950</td>
</tr>
</tbody>
</table>

Source - Banking Commission - op. cit., p. 29

The extension of credit to small borrowers in priority sectors is indeed the prime aim of nationalisation and, therefore, its magnitude is the real test of its success. After nationalisation there has been a significant increase in the flow of bank funds to these sectors. In this task public sector banks have played a prominent and dominant role as the following table indicates.

Table - 13

Total advances to priority sectors by public sector banks.

<table>
<thead>
<tr>
<th></th>
<th>Amount outstanding</th>
<th>(Rs. in Lakhs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>State Bank of India and its subsidiaries</td>
<td>20292</td>
<td>45623</td>
</tr>
<tr>
<td>Nationalised Banks</td>
<td>23567</td>
<td>83624</td>
</tr>
<tr>
<td>Total</td>
<td>43859</td>
<td>129247</td>
</tr>
</tbody>
</table>

Source - Ibid., p. 41
As for the quantum of lending by public sector banks to the priority sectors, the outstanding advances of Rs. 438 crores as at the end of June, 1969 increased to about Rs.2321 crores by the end of December 1975.

Judged, therefore, by the actual result, nationalisation of the important banks did have salutary effects on the Indian banking scene as a whole. The only other important group which has been left out of the purview of nationalisation is the foreign banks. The Government did not yield to the pressure or temptation to nationalise all the banks. Apart from avoiding the complicated problems likely to be raised by the take-over of foreign banks, there are practical advantages to be reaped in maintaining a mixed sector in banking. The operations of the privately owned banks left out may be on a very minor scale now, but the growth of new units in future may help to cater to local needs which may get neglected because of the unwieldy size and bureaucratization of the public sector.

The reason given at that time for not including the foreign banks in the scheme of nationalisation, in the words of the then Prime Minister was "So far as foreign banks are concerned, they provide by and large, business of a specialised nature such as facilitating foreign trade and tourism. The operation of banks of one country in another, subject to the laws of the land, is mainly for such purposes and is part of an international facility. Our Indian banks also maintain
their branches in many countries. It has been Government’s general policy to confine the opening of new branches of foreign banks to major port-towns, where their specialised services are needed. Having regard to all these factors, Government have decided to exclude branches of foreign banks incorporated outside India from the purview of the ordinance.\(^{25}\)

The above quoted statement assumes that the main business of foreign banks in India is the financing of foreign trade and rendering aid and service to tourists. But the actual facts, as the following chapters indicate, tell a different story altogether. The main business and source of profit for the majority of foreign banks in India, is internal trade. The Indian banks have had to face severe competition from the foreign banks, not only in the matter of financing of foreign trade - which is understandable - but also in all other spheres of activity. Therefore, the real reason for excluding the foreign banks from the purview of nationalisation is to be sought somewhere else. The fear of retaliation by the foreign countries involved or other sanctions they may take against India is a more plausible explanation than the one given by the Prime Minister. The Government, probably wanted to avoid getting unnecessarily involved in international complications that would have ruined the climate for foreign aid and investment which are still required in some measure.

\[\ldots\]

25. Commerce dated July 26, 1969, p. 171