Modern Banking: A Historical Perspective

Introduction

The history of modern banking is not old as compared to the importance it has received in the life of human being. During the last couple of centuries it has got such immense importance that it looks almost impossible now to think without a bank. Each and every development of the past few centuries has contributed to the growth and development of modern banking. Whether it is the prevalence of money, discovery of mines of gold and silver, advancement in navigation to the modern transport and telecommunications.

In this first chapter of our thesis “Recent Developments in Banking Organization with Special Reference to Islamic Banking and Finance” we would try to explore how the modern banking has evolved to its present form. We would start from the word ‘bank’ itself then proceed to explain how the banking has developed in various countries. Almost all the major countries where banking has evolved during the initial stages of industrialization are covered in the present chapter. Industrial revolution along with navigation and other transport facilities led several European countries to expand their empire much beyond their own borders, which also introduced many of their system including banking to their ruling countries.

For the sake of convenience we shall avoid describing banking system in common wealth countries except India, which we have taken for several other reasons. We will start from a brief discussion about the credit mechanism as its growth along with trade and commerce is one of the biggest factors that necessitated the organizations like banking. Then we would take up the word ‘bank’ itself, how it has come to present understanding that bank is an
The institution that does financial intermediation between the savers and the investors and provides several other services to its customers. In the next section a brief discussion on the banking history of some important countries like Italy, United Kingdom, Germany, France, U.S.A. and India is followed in the order. These discussions mainly consist of early developments of banking in the respective country, as the present form of banking in the world is not much differentiating. The early distinction of branch, unit, joint stock, group, chain and other forms of banking has blurred with the passage of time. However, some other distinctive features on the basis of specialized activities followed by a bank do still come to be recognized. For example, apart from the strengthening of Central Banking institution in every country one also finds several specialized banking institutions like development, industrial, agriculture, investment, merchant and many more at national as well as international levels. After the recent revolution in telecommunication a concept of virtual and net banking is fast catching. We have tried to introduce some of the recent developments in later part of this chapter.

The Word

The word ‘bank’ is said to have been derived from the public loans made by the Italian cities. The usual Italian name for the public loan was ‘Monte’ signifying a joint stock fund, as the Germans were influential in Italy during the middle ages their name for a joint stock fund was ‘banck’ meaning a heap or mound,¹ that the Italians converted into ‘banco’ which originally meant ‘shelf’ or ‘bench’ (Bank, Encyclopedia of Banking), however, the word was also employed for an accumulation of either stock or money.²

Another opinion states that the word bank is derived from the word, "bancus" or "banque" which means a bench because the early bankers, the Jews in Lombardy, transacted their business on benches in the market place.

The definition of a bank given in an Italian dictionary in 1659 was "Monte" a standing bank. Charles Conant quoting Cibrario Says "Regarding the theory of credit, which was invented in Italian cities, it is known that the first bank on public debt "Il Prio Banco debito publico" was erected in Venice in 1171".  

The word was adopted into English indifferently meaning public loans or stocks of money. Bainbridge in 1646 spoke of the "three banks" at Venice, meaning three public loans or Monte. The issuance of paper money directly by the State was spoken of as "raising a banke". According to Holdsworth, "In colonial days in Massachusetts, the issue of paper money was referred "Raising a Bank". The word bank meaning the money rather than institution which put it in circulation".

Modern Banking: A Historical Overview

The modern banking is said to have evolved in Italian cities during the medieval era. The private bankers of the medieval Italian cities are considered

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4 Davies reports that banking originated in Ancient Mesopotamia where the royal palaces and temples provided secure places for the safekeeping of grain and other commodities. Receipts came to be used for transfers not only to the original depositors but also to third parties. Eventually private houses in Mesopotamia also got involved in these banking operations and laws regulating them were included in the code of Hammurabi. In Egypt too the centralization of harvests in state warehouses also led to the development of a system of banking. Written orders for the withdrawal of separate lots of grain by owners whose crops had been deposited there for safety and convenience, or which had been compulsorily deposited to the credit of the king, soon became used as a more general method of payment of debts to other persons including tax gatherers, priests and traders. Even after the introduction of coinage these Egyptian grain banks served to reduce the need for precious metals which tended to be reserved for foreign purchases, particularly in connection with military activities. For details see Davies, Glyn, 'A history of money from ancient times to the present day'. (3rd Ed.) Cardiff: University of Wales Press, 2002. p. 720.
the forerunners of the modern banking. However, the mechanism of credit. As Conant observes, dates back to the civilization of antiquity. He mentions that it (the mechanism of credit) was much more developed in Assyria and Babylon than in early Greece and Romans and after its development in the latter countries during their period of military and commercial ascendancy. It was left, however, for the sixteenth century to develop a bank note in something like its modern form and for the nineteenth century to spread its use.\(^6\)

Assyria is reported to have issued a commercial instrument like promissory notes, bills of exchange and transfer cheque as early as seventh century B.C., one of the first form of banking was the exchange of foreign money for domestic money and the return of foreign money to the country of its origin.

The banking business was subjected to official regulation in both Athens and Rome. The Roman laws required a banker known as ‘argentarri’ (dealers in Silver) to produce their account for official inspection and keep a cashbook, a deposit book and a daybook. The transfer of credit was permitted at Athens by the law of Solon, and commercial paper from Phoenicia and Egypt was negotiated upon the Athenian market. As one author points out that the Greeks taught Banking to Rome and the first names for bankers were of Greek origin. The Banking business at Rome was largely in the hands of foreigners and freedmen, but certain branches of finance were in the hands of native Romans. Patricians (original habitant of Rome), in their business relations, exacted a usurious rate of interest from the Plebeians (A noble appointed by the Emperor). The regular bankers the ‘argentarri’ were charged with the organization of the coinage by Mauritius Gratidianry in the 1st century B.C.\(^7\)

The Romans’ control on politics and the business gradually extended the scope of Roman Banking, subdivided the business and resulted in the creation

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\(^7\) Holdsworth, op. cit. p. 158.
of a complete body of jurisprudence. The organization of the greater commerce and banking as it existed in the Roman persisted during the first part of the Middle Ages. However, the lack of security for property in Western Europe and the neglect of the laws of commerce gradually drove both commerce and credit within narrower limits and led to the withdrawal of metallic money for hoarding.

During the later Middle Ages the growth of commerce and accumulation of capital began to draw precious metals from their hiding places and led each seigneur to coin his own money. The diversity of weights and varying market ratio between gold and silver made the function of the exchanger an important one. The edicts of Leo the wise, the Byzantine Emperor of Constantinople, contained a series of provisions governing the moneychangers. Similar moneychangers existed in the Arabian cities also. In Italy when Venice, Florence, Naples, Genoa and Pisa became great commercial centers. The Italian bankers, were given special protections as representative of the Pope, helped in transmitting to Rome contributions collected in Europe and in several other countries. General regulations of the exchange and banking business appeared early in the Italian statues. The Jews and the Italian bankers spread their connections throughout the Western Europe. In the fifteenth century when Holland became a center of capital and enterprise, Amsterdam superseded Antwerp in commercial influence and the available capital of the world was attracted thereby the excellent organization of the bank of Amsterdam. At Hamburg the Jewish community was credited with the considerable share of the creation of public bank.

In England, the ground of modern banking was prepared with the influx of gold from America in Elizabethan age and simultaneous growth of the

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8 Davies acknowledges that after the fall of the Roman Empire banking was forgotten and had to be re-invented much later during the Crusades in Italian city-states such as Rome, Venice and Genoa, and in the fairs of medieval France, the need to transfer sums of money for trading purposes led to the development of financial services including bills of exchange. For details see Davies, op. cit.

foreign trade. Another important factor that gave impetus to English banking was rise in Goldsmith's practices firstly in the form of goldsmiths notes that became payable to bearer and secondly, when Goldsmiths started offering interest to the depositors. (See below section Banking in Great Britain)

The Two Pioneers in Modern Banking

Italy and United Kingdom (UK) are considered to be the pioneers of modern banking. In the previous section, we have seen that in Italy it were the money exchangers that paved the way for modern banking while in UK it were the goldsmiths that started the earliest form of modern banking. If one go by the business the first form of banking was exchange then deposits and then came the lending. Ownership wise first the banking was in the private hands either known as 'argentarri' in Venice or goldsmiths in UK, then a concept of joint ownership developed with the passage of time. By the end of 16th century deposit and the exchange banking had flourished on the continent of Europe with the establishment of 'The Banco di Rialto' in Venice in the year 1584. The Bank of Sweden was established in the year 1556. Exchange banks were first started in Amsterdam in the year 1609 and in Hamburg in 1690 later on they also began to do deposit banking. In the following paragraphs a description is made on the early developments of banking in various countries like Italy, UK, Germany, France, USA and India.

Banking in Italy

Italy is considered to be the mother of modern banking as it is reported to be the first country to have developed the mechanism of modern credit.

In Venice banking was in private hands and was a subject to legal regulation from time to time between 1270-1584. During the later years, however, attempts were made to create public banks. Conant quoting Tommaso
Cartamin, an Italian Senator in 1584, mentions about 103 banks, of which 96 had came to a bad end and only 7 had succeeded.\(^\text{11}\)

These early banks initially did business with their own money and subsequently with the public deposits. The use of deposit, as it appears, was not at first intended to economize cash but to avoid its frequent handling. The early bankers employed the money entrusted to them in more or less speculative ways, and many a times came by degrees to make advances to the states and to grant credits to merchants and traders without proper security.\(^\text{12}\)

Since a single individual was hardly equipped with sufficient capital to carry on the large operations involved, associations were formed for dealing with the state on the one hand and the taxpayer on the other, which became nucleus of large banking operations. Thus, great financiers grew up who dominated the politics as well as the finance of the European states. The business of banking was only a branch of the great affairs of these finance houses. According to Conant, these financiers acquired large territories, financed wars, purchased silver mines, etc. Each face of the banking was almost a necessary evolution of the conditions of that time. The moneychanger followed the merchants in his voyage over the world, when merchandise and metallic money constituted the only instruments of exchange. The creation of uniform monetary systems and wide areas of trade under a single political sovereignty, however, lessen the importance of this trade, but it was chiefly the organization of credit, permitting exchanges without metallic money, which reduced the moneychanger to an essentially subordinate place and gave birth to the modern banking.\(^\text{13}\)

\(^{10}\) For details see, Sohrab, R. Dawar, "Law and Practice of Banking", Thomson Printing Press, Mumbai, 1972, pp. 1042.


\(^{12}\) They, thus, became substantially banks of issue, they did not formally issue notes, but banking credits came to constitute certificates of deposit which circulated as currency.

One more step was taken towards devising modern banking methods when the Italian bankers received cash under the name of deposits. Thus, writes Conant, gradually emerged all the attributes of the modern banking. The individual moneychanger, the Jewish lender, the Lombard banker gradually gave way as centralization advanced in economic and political life, to public banks doing business under official authority.\textsuperscript{14}

The creation of “bank money” facilitated the complexity involved with the coinage system. The bill of exchange became a means for making productive loans. Deposits were accepted to be loaned for profit, and to attract more depositors were paid interest in lieu. The resources of the modern savings, attracted to the banks, became available for loans to the producing and trading elements. Thus, modern credit received its organization. The creation of bank notes and the extension of the mechanism of clearings and co-operation among the banks provided the motive power of the commerce.

The first attempt to form a modern bank was in the form of St. George, which began just after the French revolution that brought closer to all the ancient banks in Italy. Another attempt was made in 1844 by the Charles Albert which was to be known as Bank of Genoa. King Victor Emmanuel later on reorganized this as the National Bank of the Kingdom of Italy.\textsuperscript{15} Next to be established was the Roman Bank in 1851 and the National Bank of Tuscany in 1857. During 1890s the Roman banking plunged into deep crisis mainly due to over issuing of the paper notes. This necessitated the reorganization of Roman banking, which culminated in the emergence of Bank of Italy by merging the National Bank of the Kingdom, National Bank of Tuscany and the Tuscan bank of Credit.\textsuperscript{16}

\textsuperscript{14} Ibid., p. 16.
\textsuperscript{15} Ibid., p. 17&19.
\textsuperscript{16} Ibid. p. 23.
Banking in Great Britain

Ground of modern banking in England was prepared with the influx of gold from America in Elizabethan age and simultaneous growth of the foreign trade. Another important factor that gave impetus to English banking was rise in goldsmiths’ practices firstly in the form of goldsmiths notes that became payable to bearer and secondly, when goldsmiths started offering interest to the depositors.17

The Bank of England was started in 1694 largely as a result of financial difficulties of William III who was engaged on war with France. The public distrust of goldsmiths was also responsible for the same. One Mr. Fattorson offered to raise £1200000 for the government as a loan provided certain concessions were given to the proposed institution particularly the right to issue notes. The government agreeing to the terms passed an act called the “Tonnage Act” with the main provisions as follows:

1. It authorized the raising of £1200000 by subscription, the subscribers forming a corporation to be called “the Governor and Company of the Bank of England”

2. No person could subscribe more than £20,000 in all

3. The corporation was to lend the whole of its capital to the government for 8 percent and £4000 towards expenses of the management

4. The corporation was to have the privilege of a bank for twelve years, however, the government had the power to annul the charter after giving one-year’s notice to the corporation

17 Goldsmiths gradually discovered that large sums of money were left in their keepings for long periods. They thought it safe and profitable to lend out a part of their customers’ money provided such loans were repaid within a fixed time. Further, realizing that the business of lending of other people’s money at interest was profitable, and in order to attract large amounts, the more enterprising of the goldsmiths began to offer interest on money deposited with them, instead of charging a fee for their services in guarding their clients’ gold.
5. The corporation was forbidden to trade in any merchandise whatsoever but was allowed to deal in bills of exchange, gold or silver bullion and to sell any wares and merchandise upon which it had advanced money.\textsuperscript{18}

The new bank proved a formidable competitor to the comparatively small private banking firms. In the year 1708 another important act was passed which prohibited any other bank with more than six partners issuing promissory notes i.e. “Bank notes” The most important clause of this legislation was as follows:

“That during the continuance of the said corporation of the governor and the company of the Bank of England, it shall not be lawful for anybody, politic or corporate, whatsoever, created or to be created other than the said governor and company of the Bank of England, or for other persons whatsoever united or to be united, in covenants or partnerships exceeding the number of six persons in that part of Great Britain called England, to borrow, owe or take up any sums of money on their bills or notes payable on demand, or at less than six months from the borrowing thereof”\textsuperscript{19}. This act gave monopoly of note issue to the Bank of England so far as joint stocks banks were concerned but left private banks having not more than six partners, free to issue notes. A new legislation in 1826, however, tried to restrict the monopoly of the Bank of England and allowed establishment of new banks with unlimited liability, consisting of more than six partners, with the right to issue note with a condition not to open their offices within the radius of 65 miles from London. However, in the year 1833 the new charter of the bank gave legislative sanction to the establishment of joint stock banks in London and by the year 1834, the London Bank and the Westminster Bank had started.\textsuperscript{20}

The unlimited power to issue notes by joints stock banks resulted in numerous banking crises and failures followed by Peel’s act of 1844, which

\textsuperscript{18} ibid., p. 4.
\textsuperscript{19} ibid., p. 4.
restricted the right to issue notes to the banks then issuing and to the extent of their note issue at the time. Thus, providing for the gradual extinction of the right and laying the foundations of the monopoly of bank note issue for the Bank of England. That was an important turning point from the point of view that deposit banking came to supplant note issue banking. Now greater attention began to be paid towards deposit banking as the new banks did not have the power to issue notes neither the older ones having the right to issue notes could be able to increase their circulation. It was soon realized that cheque currency was almost as profitable as the issue of bank notes leading to gradual growth of this activity. Beginning of the 20th century followed the movement of amalgamation and absorption, which heavily reduced the number of banks. In the year 1947 the labor government nationalized the Bank of England by transferring the then existing stocks to the nominees of the British Treasury and by vesting in the crown the power of appointing its Governor, Deputy Governor and Directors.

**Banking in Germany**

The modern banking in Germany began with the establishment of Hamburg Giro Bank in 1619.\(^{21}\) This bank was formed on the model of the Bank of Amsterdam. The Bank of Prussia was established in 1765 which later on was changed to the Imperial Bank of Germany in 1875 after The Bank Act of 1875 that unified the banking system of the entire German empire.\(^{22}\) The Act covered the regulation of note issue, the nature of business, profit and their disposition. As Conant reports that by the time of this act there were 32 other banks in the country of them, two were commercial, one territorial and the rests as joint stocks banks. The Charter of these banks varied between 1-81 years except for

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three; Bank of Anhalt Dessau (1847), Bank of Bremen (1856), and the Bank of Thuringia (1856), which were regarded as perpetual. The oldest of the Bank with the limited charter was that of Pomerania established at Stettin in 1821. the Bavarian Bank of mortgage and exchange at Munich in 1834, the Bank of Leipzig in 1839, the Communal Bank of Breslau in 1848 and many more. Conant is of the view that these banks were mainly borne out of the financial necessities of the government to receive aids.23

The German banking system consisted of the Bank of issue of the Federal States, the Joint Stocks Banks, the Private Banks, the Cooperative Banks, the Savings Banks, and the Mortgage Banks.

Banking in France

The French Banking system is the result of legislation passed in 1941 and modified in 1945. To a certain extent these laws merely confirmed the organization, which had developed progressively throughout its history.24

According to Conant, the bank of France is the greatest and in many respect strongest of the bank of the world and also its development exhibits the most interesting phases of banking history outside the Great Britain.25

Banking activities appeared in the 12th century during crusades since the necessary transfer of funds could be made easily between the branches of the Temple scattered from Western Europe to the Middle East. Even during these periods the Church’s prohibition of interest loans continued in the banking operations, hitherto it had lost its effectiveness as the Popes themselves had started loaning to the bankers.26

25 Conant, op. cit. p 32.
During the Middle Ages the functions of banks were more like that of modern investment banks than that of deposit banks. Law’s plan in 1716 led to the creation of the first public bank in France, which was to be a deposit bank, an issuing bank and a colonial company. The Royal Bills, which had been issued at the end of Louis XIV's regime, became banks note secured by commercial transactions, the bank collapsed in 1720 due to speculation in spite of the big effort of the King to prevent it. This experience prevented the creation of new bank till 1776 when a discount office created by a Minister, which was established to provide credit for trading, was later used by the State for its monetary transactions. This too was closed in 1793. The following years office of the current accounts, the discount office, and commercial banking offices were established giving a preview of the Bank of France which was organized in 1800 by Bonaparte.27

The Bank of France was initially a privately owned company, which discounted bills and issued banks notes. However, in 1806 with the appointment of the Governor of the bank it was taken under the government. In 1808 the official statutes defined its business. Under the patronage of successive political regimes the bank continued to expand and grow.

By the 1st half of the 19th century banking largely remained a personal affair of the Jewish and Protestant families who formed private banks.

The development of commercial banking in the middle of the 19th century is attributed to Saint Simon who had many followers among businessman. The English joint stock banks served as models. The first bank to be created as joint stock corporation was the “Comptoir National d'Escompte de la Ville de la Paris” in 1848. Others are “Credit Industrial et Commercial” in 1859, “The Credit Lyonnais” in 1863 and “Societe Generale” in 1864. “The Credit Commercial de France” in 1894 and “Banque National de Credit” in

27 Ibid., p. 243.
1913\textsuperscript{28}. Martin reports that “Banking in France has passed through ups and downs but it has always been in a position to face the crisis with confidence mainly due to separation of deposit banking with investment operation. Though banks failures occurred but mostly in small size banks. When there was a danger of big institution might fail, the government took action: "Banque National de Credit" was reorganized in 1932 as the "Banque Nationale Pour le Commerce et Industrie", and "Banque Alsace-Lorraine" were merged with "Credit Industrial et Commercial"\textsuperscript{29}.

The first regulation of French banking came in 1930s when the government created a credit commission, which conducted an inquiry and envisaged control of the banking system. In 1941 a committee was created to prepare the definitive status relating to the regulation and organization of the banking which first time tried to define and classify enterprises in the field of banking or finance, further, it aimed to control and direct such enterprises.\textsuperscript{30}

After 1945 the National Constituent Assembly received the draft of a law for nationalization of the Bank of France and other big banks in November 1945, which was completed and modified in May 1946. The Ministry of Finance and the Bank of France were put at the top of the new hierarchy. The composition of the Bank Control Commission was modified. The Permanent Banking Organization Committee became National Credit Commerce and the Bankers Professional Associations remained the link between the profession itself and these directing bodies. The Bank of France and four other main credit establishments were declared nationalized as of January 1, 1946.\textsuperscript{31}

Financial organizations in France could be classified into the following major categories;

\textsuperscript{28} Ibid., p.244.
\textsuperscript{29} Ibid., p.245.
\textsuperscript{30} Ibid., p. 246.
\textsuperscript{31} Ibid., p.246.
1. **Private Sector**: The traditional organizations including commercial banks and financial institutions controlled by the Bank control commission.

2. **Semi Public Sector**: Institutions of special status granted by the State that enjoys certain privileges. They are mainly created by the State to perform particular banking service i.e. postal checking services, saving banks and credit banks etc.

3. **Public Sector**: It is the institution representing the government in all kinds of credit transaction.

4. **Special Purpose**: These created for the financing of reconstruction and equipment of important branches of the industry, they are connected directly with public treasury.

The law of December 1945 (Art-4) divided all banks into three categories.

1. Deposit Banks or commercial Banks (Regional, Local and Foreign Banks)
2. Investment Banks.
3. Long term and Medium term credit Banks.\(^{32}\)

**Banking in the United States of America (USA)**

The banking history of the country can broadly be divided into three separate periods; the Free Banking era (up to 1863), National Banking (1863-1913), and the Federal Reserve System (1913 till date). The banking system of the United States possesses certain distinctive features. Unlike branch banking feature in European country the United States follows a unit banking system, which is marked, by a large number of small sized banks. According to Raymond the prevalence of unit banking is the most remarkable phenomenon of the US banking system. The primary reason, according to him, is regulator’s wish to curb the growth of bigness and the concentration. Another reason

\(^{32}\) *Ibid.*
mentioned by Raymond is the limitations of the powers of state the governments.33

Another striking feature of United States banking system is the duality of control and supervision by the state and the federal governments. There is also a partial separation of commercial and investment banking in the country.

The first commercial bank incorporated in USA was the Bank of North America established in Philadelphia in 1782. It financed the short-term needs of the merchants. By the period 1836 there were about 700 state chartered banks in the country.34 The Federal government chartered the first bank of United States 1791-1811 and the second bank of United States 1816-1836; however, the permanent arrangement of the banking in the country was made with the passing of the National Bank Act of 1863.35

The Central Banking organization came into existence with the passing of the Federal Reserve Act in 1913. Federal Deposit Insurance Act was passed in 1933. Banking operations in the country came to a halt during great depression of 1930s when about 9000 banks in the country suspended their operations and an additional 2300 disappeared as a result of consolidation or absorption.36

Following table (1.1) shows mergers, consolidations and absorption activities of United States commercial banking during 1924-1951. One could observe from the below table that during nine years from 1924-33 more than five thousand mergers and consolidation took place in the US. These were the period of hectic reorganization of banking in the country. In the next two

36 ibid., p.931.
periods the average annual mergers and consolidation though declined but was still substantial averaging 190 and 88 per year.

Table No. 1.1

<table>
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<th>Period</th>
<th>Total</th>
<th>Average</th>
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<tr>
<td>1924-33</td>
<td>5257</td>
<td>526</td>
</tr>
<tr>
<td>1934-37</td>
<td>760</td>
<td>190</td>
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<tr>
<td>1938-51</td>
<td>1228</td>
<td>88</td>
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Source: Board of Governors of Federal Reserve Systems, Staff reports on concentration of banking in the United States, September 10, 1952

For the purpose of banking the whole country is divided in to different districts with each having its own federal reserve bank the coordinating body among them is called the Federal Reserve Board with its headquarter at Washington D.C. The Federal Reserve Bank is the central bank of the country. The commercial banks in the country can be divided in two, the national banks that obtains the charter from the Federal Government and the state banks which functions under the regulations of the state government. Thus the commercial banks in the country are dual regulated.

Banking in India

Money lending operations are said to be very old in the country evidences of which can be found in Vedic, Buddhist and other ancient literatures. Muslim historians and European traveler’s record that during the Muslim Rule in India indigenous bankers played a prominent part in lending money. During Mughal ascendancy various kinds of metallic money in different parts of the country provided great opportunity for money changing business, many among those traders came to be known as world bankers (Jaqat
When English traders came to India they tried to conduct banking business through their agency houses.

The first bank to make its appearance in India was the Bank of Deposit and Discount in Madras as early as 1683. After this another bank commenced operations in Bombay in 1724. Both had sanctions of the Court of Directors of the East India Company and were managed by the local government in the interest of their own financial needs.

The earliest bank started by any agency house in India was the Hindustan Bank established in 1770 by Alexander & Company which was wound up in 1832 when Alexander & Company failed. The Bengal Bank and General Bank of India were established about 1785. Later on the Bengal Bank was closed fearing attack by Tipu Sultan in the year 1791 and the General Bank of India was liquidated in 1793 owing its inability to earn profit and the reserves inflicted upon the company. These banks were chartered by the East India Company under the Act of Indian Legislature. The Bank of Bengal was the first presidency bank to be established in 1806, as the Bank of Calcutta, which received its charter as the Bank of Bengal in 1809. The Bank of Bombay and the Bank of Madras were established in 1840 and 1843 respectively.

During U.S. civil war in 1862-65 the Indian banking was thrown into a crisis, mostly due to speculative activities. The Bank of Bombay was amongst the first that went into liquidation in 1868 owing its allegiance to the massive speculation. This shook the confidence of the Indian public in the banking

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38 Ibid., p. 2-3
39 Muranjan, S.K., 'Modern Banking in India', Bombay, Kamla Publishing House, 1940, p. 4-5
41 As the supply of American cotton to England was disrupted consequently England had to depend solely on the Indian cotton. This brought immense export earnings to India, which led to speculative enterprises entering banking. Soon many institutions were overtaken by disasters.
42 Government withdrew its portion of the capital after the failure. A new bank having the same name was established immediately with a capital of Rs. 1 Crore (10 millions).
system, which resulted in hampering the growth of Joint Stock Banking in the country.\textsuperscript{43}

Between 1865-95 only two major Joint Stock banks could be established the Allahabad Bank in 1865 and Punjab National Bank in 1895. During 1906-\textsuperscript{13}, the National (Swadeshi) Movement resulted in establishment of many banks like, Bank of India Ltd. in 1906, Indian Bank Ltd. in 1907, The Bank of Baroda Ltd. in 1909 and The Central Bank of India Ltd. in 1911, etc.

From the early days of the East India Company to the year 1833 banks were established on the basis of unlimited liability. They transacted ordinary banking business and financed internal trade. They also issued notes for circulation. Most of these banks ended in failure owing to the combination of banking with other business and speculation. From 1833-1860, majority of the banks failed due to speculation and mismanagement. Some of the banks, however, were successful.\textsuperscript{44} After the adoption of limited liability principle in 1928 even more number of banks failed. Panadikar reports that 481 banks failed during the period of 1913-36 and between 1937-43 another 475 banks had failed in the country.\textsuperscript{45} If one takes into account the banking history of the country during first half of the 20\textsuperscript{th} century around 1000 banks failed for various reasons from mismanagement, speculation to fraud. Keeping in view the safety following restrictions were imposed upon the three presidency banks:

1. They were prohibited to deal in foreign bills and borrowings abroad.
2. They were prohibited to lend for more than six months period.
3. They were also prohibited from lending on the immovable properties.

Most of the early banking failures in India could be attributed to lack of proper management and speculation, however, a good number of these bank failures were also fueled by rumors and lack of confidence among the bankers.

\textsuperscript{43} Ibid.

\textsuperscript{44} For details see the Government of India, 'The Indian Central Banking Enquiry Committee'. (Part I). Calcutta, Government of India, Central Publication, 1931, 522, p.

\textsuperscript{45} Panandikar, S.G., Op Cit., p 14-15
themselves, which forced the authorities to think for a centralized banking institutions in the county. The Imperial Bank of India, which was carved out of the three presidency banks, is the reflection of that necessity. The following paragraphs have some more details of it.

The banking crisis during the First World War forced the government of India to amalgamate the three presidency banks into the Imperial Bank of India in the year 1920. This bank was later on, after the independence of the country, converted into the State Bank of India in 1955. Some other princely state banks were merged or converted as the associates of the State Bank of India. The Central Bank in the country was established separately as the Reserve Bank of India in 1933.

Most of the foreign banks in India were established under a Royal Charter or English legislation. The first Anglo Indian Commercial Bank to receive a Royal Charter was the Oriental Banking Corporation, which was formed by amalgamation with the Bank of Western India in 1842 at Bombay. In the year 1853 the Chartered Bank of India, Australia and China, and the Chartered Bank of Asia were incorporated. Of the three-chartered banks the Oriental Bank failed in 1804 and the Mercantile Bank (Chartered Bank of Asia) had to relinquish its Charter in 1893 and reconstruct itself as the Mercantile Bank of India under the English Companies Act.

46 Although efforts were being made since 1836 to establish a foreign bank under the Royal Charter but East India Company and its associate agency house banks were successful in preserving banks in India charted by it from the competition of English banks. They were apprehensive that these banks would make profit at their expense on their annual remittances for home expenditure. The 1st such proposal for incorporation in London of an Anglo-Indian Bank, called the Bank of India was made in 1836. However, the East India Company and its agency banks were opposed to the idea on the ground that they would be able to extend their services to the government and the country in all directions contemplated by the proposed bank. The next project was the Bank of Asia of 1840, which met with the same fate as the Bank of India, owing to the opposition of the agency houses, which had recovered from the disastrous failure of 1829-1832.
Evolution of Central Banks

Banking experiences in several countries had taught the regulating authorities to confine the right of note issue to a single institution (called bank of issue). This right was granted either to an already functioning institution or a separate institution was created for the purpose. These institutions had special power and privileges accompanied by varying degrees of state control and supervision. In due course such bank of issue acquired other functions, duties and powers and by the end of the nineteenth century almost every country in Europe along with Japan and few in Africa had established a bank of issue with special privileges and powers. Most of these banks later on assumed the role of a central bank in their respective country. However, it was only till the twentieth century that the term ‘central banking’ came to be applied to such institutions.47

International financial conference which was held at Brussels in 1920 passed a resolution to the effect that all countries which has not yet established a central bank should process to do so as soon as possible not only with a view to facilitating the restoration and maintenance of stability in their monetary and banking system but also in the interest of the world cooperation. Since that time, central banks have been established not only in the existing independent or self governing centers which did not yet had a central bank but also in many new independent states which had been created later on.48

At present a Central Bank is generally recognized as the bank which constitute the apex of the monetary and banking structure of its country and performs the national economic interest in the following ways;

1. The regulation of currency in accordance with the requirements of business and the general public.

47 Dekock, M.H., ‘Central Banking’, Universal Book Stall, New Delhi, 1997 p. 4
48 Ibid., p....9.
2. The performance of general banking and agency services for the government.
3. The custody of the cash reserve of commercial banks.
4. The custody and management of nations reserves of international currency.
5. The provision of credit facilities.
6. The settlement of clearance balances between the banks.
7. The control of credit in accordance with the needs of business and economy.\(^49\)

By the beginning of the twentieth century following banks had already assumed the role of the central banks in their respective country.

**Table No. 1.2**

<table>
<thead>
<tr>
<th>Name of the Bank</th>
<th>Year of Establishment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Riks Bank of Sweden</td>
<td>1656 (Reorganized as State Bank of Sweden in 1668)</td>
</tr>
<tr>
<td>Bank of Netherlands</td>
<td>1804 (After the Bank of Amsterdam became discredited)</td>
</tr>
<tr>
<td>The Bank of Austria</td>
<td>1817 (reorganized as Bank of Austria and Hungary in 1878)</td>
</tr>
<tr>
<td>Bank of Norway</td>
<td>1817</td>
</tr>
<tr>
<td>National Bank of Copenhagen</td>
<td>1818 (Now known as the National Bank of Denmark)</td>
</tr>
<tr>
<td>The National Bank of Belgium</td>
<td>1850</td>
</tr>
<tr>
<td>The Bank of Spain</td>
<td>1856 (Sprung from State Bank founded in 1829)</td>
</tr>
<tr>
<td>Bank of Russia</td>
<td>1860</td>
</tr>
<tr>
<td>Reich Bank of Germany</td>
<td>1875</td>
</tr>
<tr>
<td>Bank of Japan</td>
<td>1882</td>
</tr>
<tr>
<td>Bank of Italy</td>
<td>1893</td>
</tr>
<tr>
<td>Swiss National Banks</td>
<td>1907</td>
</tr>
</tbody>
</table>

*Source Central Banking, De Kock. M.II., op cit*

In India, Hilton Young Currency Commission recommended in 1926 for creation of a Central Bank to be called the Reserve Bank of India to perform

\(^{49}\) Ibid., p 16.
the central banking functions.\textsuperscript{50} Finally, a bill providing for the establishment of the bank was introduced in the central legislature in 1933 and was passed in 1934.\textsuperscript{51} The Reserve Bank of India commenced its work in 1935. The bank was later nationalized on January 1, 1949.

Later Developments in Banking Forms

Nineteenth century mechanical discoveries resulted in great expansion of trade and commerce. Unmatched production of goods and invention of new means of transportation paved the way for commerce to become a matter of worldwide interest.\textsuperscript{52} Great Britain (UK) being geographically at the center of the land hemisphere controlled most of the routes to the continent. This position, along with London being the chief financial market of its time, gave her an early edge to carrying out trade at the worldwide level.\textsuperscript{53}

After the end of the First World War the preeminence of London was overtaken with the consequent rise of New York, as much of the war indebtedness was liquidated by gold shipment. This resulted in making New York the chief free market in gold. Much Business then found its way to New York. This was helped by the fact that America had great resources, which she was prepared to lend for the reconstruction of their economies.\textsuperscript{54}

Post war years; therefore saw the emergence of new financial market as well as institutions involved in multilateral lending and borrowings. This

\textsuperscript{50} The commission further recommended that the Reserve Bank of India should be a shareholders institution and that the members of the Indian legislatures (central & provincial) should be debarred from serving as directors of the bank so as to eliminate the danger of political pressure being exercised on the board of the bank.

\textsuperscript{51} First the bill was introduced by the government in the legislative assembly in 1927, but was withdrawn because the assembly desired the bank to be a state institution and a proportion of its director to be members of the legislature in the peculiar conditions of the country.


\textsuperscript{53} Ibid..

\textsuperscript{54} Ibid..
phenomenon was come to be known as International banking. Many of the joint stock banks in UK and US entered in this arena mostly by three methods.

1. By opening up branches in foreign countries.
2. By buying up a part and if possible controlling part of capital of existing foreign banking firms.
3. Forming affiliated institutions operating under the laws of the respective countries in which they were formed.

The growing internationalization of banking received a great impetus from the very rapid post war developments of telegraphic, telephonic and wireless communication and the equally rapid growth of the new foreign exchange markets in the chief financial centers.55

Reconstruction efforts in many of the war torn European countries necessitated the establishment of multilateral financing institution which was materialized through the establishment of International Monetary Fund and the World Bank.

**International Banking**

The idea of international banking was realized through the establishment of International Monetary Fund in December 1945 and International Bank for Reconstruction and Development (IBRD) in 1946 when representatives of forty-four countries, under the Britton Wood plan, decided to founded these two institutions;

**International Monetary Fund**

This was mainly established to enhance the monetary cooperation, facilitate monetary exchange, and maintain the exchange rate stability among the member countries. The aims of the IMF are to promote international

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55 Ibid...
monetary cooperation and exchange rate stability to assist in the removal of exchange restrictions and to assist in establishing a multilateral system of payments. It seeks to facilitate expansion of the world trade with a view to promote high levels of employment and income and develop the productive resources of its member countries.

The World Bank

The World Bank consists of International Bank for Reconstruction and Development (IBRD) and the International Development Association (IDA). Its private sector arm is International Finance Corporation (IFC).

The IBRD began its operation in June 1946; its broad aim is to provide and facilitate international investment for increasing production, raising standard of living and helping to bring a better balance in the world trade. It has been rendering yeoman’s services for post war reconstruction in Western Europe and for the development of under developed countries all over the world. The major objectives of the IBRD are: reconstruction and development, capital investment from higher income country to low income country and payment adjustment encouraging developed countries to invest in developing countries and raising the standard of living.

The International Development Association (IDA) was established in 1960 to provide assistance to the poorer developing countries on terms that would bear less heavily on their balance of payments than IBRD loans.

International Finance Corporation (IFC) was established in 1965. Its function is to assist the economic development of less developed countries by promoting growth in the private sector of their economies and helping to mobilize domestic and foreign capital for this purpose.

The IBRD, IDA, and IFC have three interrelated functions: to lend funds, to provide advice and to serve as a catalyst to stimulate investments by others.
Development Banking

Another very important constituent of the modern banking emerged after the world war two. The origin of the development banking can be traced back to the incorporation of the Industrial Bank of Japan. The concept is basically the outcome of the necessity of restructuring the war torn industrial economies of several countries. The basic aim of development banking was the financing of the industrial concerns. After the World War II many regional development banks were established on the basis of economic cooperation of the region. Commonwealth countries also started establishing their own industrial, agriculture banks after they got independence from their rulers.

An offshoot of development banking, these institutions were mainly established keeping in view the increasing reliance on international economic cooperation. The pioneering efforts in this respect was the European Investment Bank (EIB) which was established in 1958 under the treaty of Rome from which emanated the European Economic Community (EEC). Foundation of European Investment Bank gave impetus to the establishment of similar institutions elsewhere. Thus the Inter American Development Bank (IADB) was established in 1959. This was followed by setting up of African Development Bank (AFDB) in 1964 and Asian Development Bank (ADB) in 1966. The idea to establish Asian Development Bank was originally mooted at the first Ministerial Conference on Asian Economic Cooperation held in Manila in December 1963. Strictly speaking the term Regional Development Bank refers to those development banks, which have been founded by certain country groups in different parts of the world to foster their rate of economic growth and social progress through regional economic cooperation. Generally regional development banks operate on continental level.

56 For details see Sikidar, Sujit., ‘Development Banking’, New Delhi, Sultan Chand & Co., 1985, pp 244.
Virtual Banking

Broadly speaking, virtual banking denotes the provision of banking and related services through extensive use of information technology without direct recourse to a bank by the customer. The origin of virtual banking can be traced back to 1970s with the installation of Automated Teller Machines (ATM). Subsequently, other types of virtual banking services have grown in prominence like Shared ATM networks, Electronic Funds Transfer (EFT), Smart Cards, Stored Value Cards, phone banking and Internet & Intranet banking etc.

Virtual banking services have been increasing very fast even in the developing countries due to their manifold financial benefits like low cost services due to higher economies of scale, prompt services through electronic modes, the lower cost of operating branch due to reduced staff costs, enlarged range of services in comparison to the conventional banks services.

The popularity that virtual banking services have won among the customers, owing to speed, convenience and round the clock services they offer, is fast catching the customers.\(^{58}\)

In this present chapter an attempt is made to briefly highlight the historical developments of modern banking in several countries. In the next chapter we shall take up the issues of recent banking reforms undertaken in several countries after the banking crises especially during 1990s.