CHAPTER VI

THE RESERVE BANK OF INDIA
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The money market of any country or region is influenced, to a considerable extent, by the central bank which controls and guides its operations with a view to ensuring adequate flow of financial resources into the market, establishing a certain measure of rapport between its different constituents, and in overcoming seasonal deficiencies or surpluses that may emerge in the market either from the side of demand or supply. The central bank comes to the rescue of the money market as a lender of last resort, helps in the establishment of specialised institutions or financing specific requirements of trade and industry, acts as a clearing house agency and incidentally serves as a source of inspiration and guidance to the different constituents by providing important statistical information, interpreting the implications of current and perspective events and giving its expert advice on various issues from time to time.

In an underdeveloped economy, the central bank is primarily concerned with creating a newwork of financial institutions for accelerating the pace and pattern of economic development rather than with imparting stability in the flow of funds. It has to
focus its attention on the mobilisation of savings and their canalisation into the most profitable channels by integrating the different parts of the money market.

How far the central bank of our country, viz., the Reserve Bank of India has discharged its obligations towards the money market in Bangalore? This is the question which has to be examined. In this chapter we therefore, propose to undertake an analysis of the factors that have helped and impeded the growth of the money market at Bangalore, and the possible measures which can be taken by the Reserve Bank of India to make the functioning of the money market more effective.

The Reserve Bank of India:

The Reserve Bank of India started functioning with effect from 1st April, 1935 with definite obligations, functions and powers, primarily directed at securing the integrated control of credit and currency in the country, regulating the issue of bank notes and the keeping of reserves with a view to securing monetary stability of the country to its advantage.

The Bank was to participate actively in the monetary structure of the country, especially for the removal of factors impeding the growth of a sound financial mechanism on the one hand and the quick rehabilitation, reorientation and development of a national banking

* The Reserve Bank of India Act, 1934, preamble.
structure on the other. In other words, it was for the evolution, development and reorientation of the Indian money market on the one hand and the creation of regional and local financial centres on the other that the Reserve Bank of India appeared as the 'Morning Star on the horizon'.

Achievements of the Reserve Bank of India:

The achievements of the Reserve Bank of India in different spheres have been remarkable. It has succeeded in general to a considerable extent in reorganising the credit structure, in guiding and regulating the banking business, and in providing the Central & the State Governments, at different levels with development finance necessary for the success of our Five Year Plans. It has filled a wide gap in the banking structure of the country. It has efficiently operated its Issue and Banking Departments and the Exchange Control Department. It has been able to control the credit and currency operations within the country and to implement the policies formulated for the economic development of our economy.

Credit regulation assumed importance with the fairly rapid growth of the economy as part of a series of Five Year Plans. Although the First Five Year Plan began some time in 1951-52 inflationary pressures gathered momentum only from the time of the Second Plan onwards in 1956. Apart from the expanded credit demand from the private sector, the primary source of inflation in the Indian economy has been budgetary
deficits of the Central Government. Credit policy in the ordinary way cannot be of much avail in a context where the biggest monetary expansion is occurring through deficits of the Government sector. However, even in such a situation, the central bank of a country has a role to perform, viz., preventing any marked secondary inflationary pressures as a result of rising liquidity of the banking system. In this spirit, the Reserve Bank has endeavoured to control credit expansion for the private sector. The Reserve Bank now possesses all the usual instruments of central Bank regulation, viz., bank rate, open market operations, variable reserve ratio and selective credit controls. All these instruments, besides moral suasion, have been used, though one can always quarrel with the extent of the use of the various instruments and their timing.

It will be beyond the scope of the present work to go into all the details of the Reserve Bank of India's operations and their effects on the economy as a whole. They will be referred only in the course of our discussions relating to the Indian money market in general and Bangalore money market in particular. We propose to examine the working of the Reserve Bank of India with a special reference to the points which have a direct bearing on the Bangalore money market.

The Reserve Bank of India & the Growth of Commercial Banks' Deposits:

There has been a phenomenal growth of deposits with commercial banks after their nationalisation in 1969, as indicated in an earlier
A significant shift from current to savings bank account and a certain measure of penetration into rural areas, consequent on the opening up of fresh offices in the unbanked centres, have been other notable trends within the section of the money market. The branch expansion programme has brought the banks closer to the clients and augmentation of their deposits has increased their capacity to meet the demands of the community. The Reserve Bank of India has indirectly helped in the process of deposit expansion through its readiness to provide funds to the Government to meet its deficits and thereby increased the flow of incomes and step up the rate of savings. Though the relative mobilisation of total income mobilised through bank deposits has remained almost static at around 15%, the rate of savings has varied from time to time.¹ The accretions of deposits with the banking system can nonetheless be attributed to the efforts of the Reserve Bank of India. The stepping up of the interest rate, specially on the term deposits has been instrumental in bringing about shift of short term deposits towards relatively long term deposits.

So far as the State of Karnataka is concerned, the deposits of commercial banks have registered considerable rise between 1971 and 1975. So too has been the extension of the bank branches all over the State. The average population served by a branch has also improved during the same period. Of the 864 new branches opened since July, 1969, following the directive given by the Reserve Bank of India, more than 50% have

gone to hitherto unbanked or underbanked areas. Along with this active branch expansion, the leading public sector banks have introduced a variety of novel schemes to meet the credit needs of different sections of the people, especially those who are economically weaker.

The rate at which branch expansion programme has been pushed forward in recent years, compared with the period immediately after nationalisation has, however, declined. The proportion of banks opened in unbanked centres in 1970 came to 74.24% for Karnataka as compared to 68.8% for the country as a whole. In 1975, this proportion fell in Karnataka to 20.2% as compared to 30.5% for the country. One consequence of this has been the continuation of inter-regional disparities in the availability of banking infrastructure. Instead of aiming at an increasing spatial distribution of branches, the banks have apparently shown their preference for relatively those areas which have already endowed with better banking facilities. Bangalore, Belgaum, Dharwad and South-Kanara account for more than 50% of bank branches even at the end of December, 1975. By contrast the districts of Bidar and Gulbarga and, to some extent, even Kolar, Hassan and Raichur and Tumkur still suffer from inadequate banking facilities.* This calls for immediate correction of inter-regional imbalances, if the proclaimed intention behind nationalisation of commercial banks is to

* Vide Table 4-6 Chapter IV.
be fulfilled. The proclaimed intention behind nationalisation was that the banks were to move away from their traditional security-oriented lending policies to production-oriented borrowers and be physically present in the midst of communities they propose to serve.

The total deposits mobilised by commercial banks show an increase of more than 150% between 1970 and 1975, thanks to the programme of branch expansion taken up after nationalisation. The performance of individual branches, however, has not exhibited the same improvement. The average amount of deposits per branch in the State has remained almost unchanged around Rs. 32 lakhs during the aforesaid period, as compared with an increase of the amount from Rs. 58 lakhs in 1969 to Rs. 67 lakhs in 1975. The per capita deposits for the State comes to about Rs. 190 which, as a proportion of average income, comes to about one fourth. Considering the low per capita income of the State, this figure should be considered to be satisfactory.

Growth of Resources - Co-operative Institutions

The Reserve Bank of India has extended financial assistance to co-operative institutions in a variety of ways. The volume of short-term financial accommodation provided by the Bank to State Co-operative Banks has registered a significant rise between 1970 and 1975. The expansion of co-operative banks would have been impossible in the
absence of the initiative and drive launched by the agricultural credit department of the Reserve Bank of India. The close association of the R.B.I. with the State Co-operative Banks has brought an expeditious transmission of agricultural credit on the one hand and helping the mobilisation of rural savings into co-operative institutions on the other.

So far as the State of Karnataka is concerned, the number of co-operative institutions, their membership, their share capital and the amount of deposits attracted by them have all gone up between 1970 and 1975, both in agricultural and non-agricultural sectors. This has strengthened their base to prove larger credits to their members. But there is a subtle feeling among the co-operative institutions that commercial banks have come as rival institutions in the rural areas.

The time has now come when a certain amount of co-ordination and integration between co-operative banks on the one hand and commercial banks on the other is to be achieved. The R.B.I. should address itself to this task. Within the co-operative sector itself, there has been a tendency to depend more on loans from higher agencies, including the R.B.I., rather than on deposits for augmenting their resources. This is also a trend which should be reversed if co-operative banks are to stand on their own feet. For the present, co-operatives have no worthwhile deposit base at all. Perhaps the increase in overdues and the relative slackness in recoveries explain the resort of co-operative
institutions to loans from higher agencies. Commercial Banks could probably play a more significant role in establishing a liaison with the co-operative banks, instead of competing with them in attracting deposits or advancing loans in rural areas.

Growth of Advances of Commercial Banks; Control by the R.B.I.: 

Along with the growth of deposits, the advances of the commercial banks have also registered an increase during 1970-75 as already noted in an earlier chapter. What is more significant, there has been a significant change in the pattern of advances as also in the strategies adopted for sanctioning the same. Encouragement given to the nationalised banks to defray small loans to weaker sections of the society so as to broadbase the process of development is a basic change in the character of control by the R.B.I. After nationalisation, the incidence of fraud increased and the repayment of loans and advances is unsatisfactory. This means erosion of capital in the banking system. \(^2\) This matter should receive the immediate attention of the Reserve Bank of India.

So far as the state of Karnataka is concerned, the advances of the commercial banks show an increase of about 225% between 1969 and 1975. The district of Bangalore has received the largest amount. Other districts like North Kanara, Coorg, Mandya, Belgaum and Bidar have more or less been neglected. A large number of branches in the state have concerned with the problem of increasing demand for credit, as a result of encouragement given to weaker sections of the society. This has brought about

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\(^2\) Basu, C.R. Central Banking in a Planned Economy, TMH, New Delhi, 1977, p. 276
an improvement in credit deposit ratio year after year. From 78.39 in 1970, this ratio has gone up to 94.2 at the end of December, 1974, for the state of Karnataka, as contrasted with a decline from 75.96 to 71.04 for the country as a whole for the same period. This suggests that the resources of the State having been mostly made available for the economic development of the State itself instead of being diverted outside.\(^3\) Within the State, however, the existence of wide variations in the ratio for different districts suggests that the distribution of advances has not been conducive to the development of the State on a balanced basis. The districts like Bangalore, Bellary, Chitradurga and Shimoga had a credit-deposit ratio of more than one at the end of June 1973. By contrast, this ratio worked out at less than 0.5 for Belgaum, Bidar, Coorg, Mandya and North Kanara. The R.B.I. could not help in correcting these inter-regional disparities.

So far as the deployment pattern of credit is concerned, loans to agriculture as proportion of total bank advances have exhibited a declining trend in recent years, despite readiness of banks to consider loan applications on the basis of credit worthiness. The proportion of advances to small scale industries have, however, recorded a significant increase from 8.6\% in June 1969 to 13.2\% in June 1974. Special advancement schemes have been adopted to grant overdraft facilities for agricultural repairs.

From the above trends, it will be evident that so far as deposit expansion and advance facilities are concerned, the R.B.I. has been partially successful. The credit base has been augmented, and the distribution of credit has also been qualitatively improved. But, from the viewpoint of regional balance and the balance between demand and supply, the R.B.I.'s role has not come up to expectations. The change in the structure of deposits has not been 'matched' with a corresponding change in the pattern of advances. *

R.B.I. and Growth of Advances of Co-operative Institutions:

The advances of Co-operative Institutions registered a significant increase between 1970 and 1975 at all levels—Primary Agricultural Credit Societies, Primary Non-agricultural Credit Societies, Central Co-operative Banks and State Co-operative Banks. Land Development Banks have also recorded expansion in the loan operations during the same period in the country. The net increase in the advances of co-operative institutions in Karnataka may be seen from the following Table:

* Vide Chapter IV - The Financial Flow.
TABLE No. 6-1

ADVANCES OF CO-OPERATIVE INSTITUTIONS IN KARNATAKA
(Rs. Crores)

<table>
<thead>
<tr>
<th>Institutions</th>
<th>Advances 1969-70</th>
<th>Advances 1974-75</th>
<th>Increase</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Primary Agricultural Credit Societies</td>
<td>43.82</td>
<td>80.30</td>
<td>36.48</td>
</tr>
<tr>
<td>2. Primary Non-agricultural Credit Societies</td>
<td>18.47</td>
<td>37.80</td>
<td>19.33</td>
</tr>
<tr>
<td>3. Central Co-operative Banks</td>
<td>64.01</td>
<td>120.13</td>
<td>56.12</td>
</tr>
<tr>
<td>4. State Co-operative Banks</td>
<td>34.03</td>
<td>53.07</td>
<td>19.04</td>
</tr>
</tbody>
</table>


As we can see from the above table, the total advances of co-operative institutions in the state increased from Rs. 160.33 crores to Rs. 291.30 crores during the five year period.

Most of the loans have been advanced for short periods to cover the needs of agriculturists for their seasonal operations. Medium-term loans have accounted for a relatively much smaller proportion, of the total loans sanctioned. Long-term loans have been virtually neglected. The R.B.I. has taken several steps to strengthen and streamline the working of co-operative institutions in recent years.

4. Ibid. pp. 292-93
It has contributed to the share capital of co-operative credit institutions, co-ordinated credit with marketing and processing activities and extended assistance to improve the administration of co-operative societies. It has also taken special steps to dilute the conditions of credit eligibility in the case of small farmers by relaxing the ratio of share holdings to borrowings. It has further attempted to introduce a certain measure of discipline in the operation of credit limits sanctioned for seasonal agricultural operations. The link between commercial banks and co-operative societies has also been strengthened by a scheme of financing primary agricultural credit societies through commercial banks. Despite a significant increase in the financial assistance by the R.B.I. to co-operative sector, there has been a long standing complaint against their working. It has been alleged that most of the loans of co-operative societies have gone to relatively richer members and, as a consequence, the needy, marginal and small farmers have been neglected. It has also been argued that in most of the societies, outstandings have increased both in absolute and relative terms. In the non-agricultural sphere, the extension of functional coverage is rather limited. Regional disparities in the distribution of loans have also been brought to light. From the above details, it will be evident that the R.B.I. has achieved a substantial measure of success in injecting funds to the co-operative

5. Basu, C.R. Central Banking in a Planned Economy, KDMH, New Delhi, 1977, p. 156
sector and through it, to the rural sector as a whole. This has only led to the dependence of co-operative institutions on the R.B.I. for financial support. Their efforts at mobilisation of deposits have been slackening in view of the easy access to the loans from the Bank. Advances have increased because of unsecured borrowings from higher institutions and ultimately from the R.B.I.

As said earlier in the chapter on the Financial Flow, their paid up capital, reserves and deposits come to only Rs. 55.19 crores indicating that they have no worthwhile owned funds base. Therefore, it is necessary to examine the issue afresh and to introduce a system of incentives and disincentives for linking loans to deposits attracted by the co-operatives themselves. A penal rate of 1% may be charged on loans granted to societies which fail to show a satisfactory performance in deposit mobilisation. A similar penalty could be imposed on those banks which show default in repayments of the loans sanctioned at the maturity dates.

It could also be considered whether commercial banks could grant loans to co-operatives to provide an alternative agency for replenishment of funds in times of need. For overcoming seasonal variations in the demand for credit, appropriate steps could be taken to develop a special type of bills which could be discounted with licensed dealers.

R.B.I. & Development of Specialised Financial Institutions:

Besides assisting the growth of deposits of commercial and co-operative banks through its policy of meeting governmental deficits
and stimulating and regulating the flow of funds into different channels, through its policy of rediscount facility and direct loans, the R.B.I. has also created a large number of specialised institutions in recent years. Its promotional role has assumed greater significance compared to its regulatory responsibilities.

In the field of rural credit, the Bank has not only restructured and strengthened the co-operative institutions, reduced regional imbalances by filling up credit gaps and brought about a realignment in the interest rate structure but also helped in providing medium and long-term loans for various approved purposes. The National Agricultural Credit (Stabilisation) Fund, the National Agricultural Credit (Long-term operations) Fund have been utilised for these purposes. Land Development Banks have been stimulated to float debentures with the support of other constituents of the money market, viz., LIC, SBI, and its subsidiaries, commercial banks etc.

In the field of industrial finance, too, the bank has done a very good job of establishing or assisting the establishment of several new institutions like IFCI, IDBI, SFCs etc. The Unit Trust of India has also been set up to promote small savings and channel them into shares and debentures of corporate enterprises.

Export Credit Guarantee Corporation Ltd., has been set up to extend guarantees for covering risk incidental to movement of goods by ships. The Credit Guarantee Corporation of India Ltd., and the Deposit
Insurance Corporation have also been set up to provide protection to the depositors against the possible loss resulting from default in loan repayments by borrowers.

The Bank has also carried out inspection of commercial and co-operative banks to secure compliance with the provisions of the Banking Regulation Act and other directions issued by the Bank or the Government from time to time. It has supervised branch expansion checked up accounts and rendered expert advice on mergers and consolidations. It has extended its expert advice to the banks and co-operative institutions in financing industrial activities. Through its publication works, it has disseminated information and research findings for the benefit of different constituents from time to time.

It is difficult to assess the contribution of the R.B.I. in the promotion of Bangalore money market in quantitative terms. There is no doubt that from the qualitative angle the Bank has done the job well enough. However, there is a feeling that the bank has been put to enormous strain on account of assuming the aforesaid wider responsibilities. If some of the activities could be entrusted to the institutions created by the R.B.I., more time and energy could be available to the R.B.I. authorities for carrying out its primary responsibilities of widening the net of savings, deposits and advances and of ensuring monetary stability over time and certain measure of 'balance' over territory.
Administration of Clearing Houses by the Reserve Bank of India:

With regard to the management of Clearing Houses which assist banking institutions to maintain liquidity and provide velocity to their dealings, the Reserve Bank of India has undertaken to supervise the conduct of clearing houses at most of the centres at which it has its offices or branches. At present, it supervises seven important clearing houses at Bangalore, Bombay, Calcutta, Kanpur, Madras, Nagpur, and Delhi. As has been discussed elsewhere*, some of these clearing houses need expansion and democratisation.

Liberalised Remittance Facilities rendered by the Reserve Bank of India:

The liberalised remittance facilities is another important service that R.B.I. renders to constituents of the money market. It was originally introduced on 1st October, 1940 to facilitate the transfer of funds of scheduled banks between the important centres in the country. Today, it is being extended to co-operative banks and affiliated central banks. Again much headway in this direction was made since 1st September, 1951 after the acceptance of the recommendations of the Rural Banking Enquiry Committee (1950). This service which was provided in the first instance twice a week, has been extended four times a week. At present, the scheme is in operation in the places where the R.B.I. has its offices or branches or has established currency chests. The Scheme provides a channel for the free transfer of funds from one place to another and secures most effective use of the available financial resources.

* Vide Chapter VIII on Banker's Clearing House.
Reserve Bank of India and Integration of the Money Market

It is well known that the Indian Money Market scene is characterised by plurality of agencies which either have no links or have imperfect links and interest rates among them very considerably. There is no reason to believe that the perfect mobility of funds exists. Even if it is there it does after a time lag. The unorganised agencies consist of money-lenders, land lords-cum-traders, pawn brokers chit funds including better organised shroffs and urban bankers. These agencies supply anywhere between 40 to 50 per cent of credit needs of the total economy.

The unorganised money market has of late been strengthened with the additions of unaccounted money, variously known as black money or unaccounted gains or untaxed accounts. A conservative estimate placed the amount at about Rs. 1300 to Rs. 1500 crores or even more. The more unique aspect of unaccounted money is that except when it is hoarded, it never remains permanently concealed, not even for a continuously long time. A large portion of it is in circulation and constantly changes its character. The impact of unaccounted money is very significant. With the growth of unaccounted money in the country, a number of mushroom indigenous bankers have grown up. These indigenous bankers are quite different from traditional bankers and it is reported that they have been lending at scrupulously

high rate of interest. The indigenous money market itself has become a lawless market and even old conventions have least relevance to it. The unaccounted money as a part of the indigenous money market is being invested in property, small scale industry, smuggling hoarding and trade.

The level of interest rate in the unorganised sector is two to three times the rate charged by banks. The higher interest rates in the unorganised money market can be attributed to the allowance for (a) higher bad debts, (b) delayed payment, and (c) unsuitable and non-marketable collaterals. But, the most important reason for the difference arises on account of short term gains frequently made by deploying funds for speculation. The opportunity cost of lending is the gain foregone and/or loss avoided by holding goods for speculation. Thus, unaccounted money has further strengthened the indigenous money market and further limited the effective implementation of the monetary policy of the Reserve Bank of India.

Since there is no direct link between the organised and unorganised money markets, there is a necessity to establish a link. The link of commercial bank between the two markets is so thin that it is more advantageous to unorganised market than to the organised market.

In the past, the Central Banking Enquiry Committee had recommended the development of direct link between money lenders and
the indigenous bankers and the R.B.I. in the same way as commercial banks are linked. "Such indigenous bankers as are engaged in banking proper or prepared to shed their business other than banking should be eligible to be placed on the approved list of R.B.I. in the same manner as commercial banks".  

The Rural Banking Enquiry Committee had also suggested that (i) Indigenous bankers should be linked with the Central Banking Institution, (ii) they should be treated as member banks, on approved list of banks, (iii) Commercial Banks might discount their bills more easily, and that (iv) Indigenous bankers should be licenced.

The Committee of Finance for the Private Sector after a careful study of the problem had suggested "pending direct linking of the Indigenous bankers with the Reserve Bank of India, we consider that steps be taken to encourage the re-discounting by the R.B.I. of usance bills of indigenous banking communities".  

Although this was accepted by the R.B.I. it has been discontinued since 1962, instead R.B.I. introduced the Bill Market Scheme.

Unfortunately the links on the lines indicated by many committees and Commissions, could not be established in the past.

What is perhaps needed is the adoption of the scheme of association recommended by Central Banking Enquiry Committee in 1931 with modifications to suit the present day economic conditions.

The recommendations of the Committee were based on two fundamental assumptions; (i) The existence of high demand for credit which the organised sector was unable to satisfy and (ii) to utilise the experience, training and resources which the indigenous bankers had. Both these assumptions seem valid today. The organised sector is even now inadequately equipped to meet all the legitimate requirements of credit. While the Committee was chiefly concerned with reorganising indigenous bankers as a class so as to develop a bill market on Western lines, our suggestion is to bring them into closer contact with the commercial banks through instrumentality of Commercial bills. Past experience has shown that indigenous bankers are inclined to bifurcate the trading activities from banking and efforts made to reform them as a precondition for associating them have not succeeded. It is doubtful if measures to enforce observance of regulated practices would succeed because for all practical purposes, the indigenous agencies are not subject to any uniform or system of discipline. Therefore, a better strategy would be to influence their activities through the existing channels of contact with the organised sector. In an underdeveloped country wherein unorganised money market predominates, the bill market
acts as a governor of the unorganised money market within the fold of Central Bank Control and also links the unorganised market with that of the organised.\(^9\)

A properly developed bill market will act as a media between the organised and unorganised money market in the country. Moreover, where the unorganised money market occupies a more important place in relation to the total resources of the country, growth of the discounting facilities acts in the same way as subsidy, but it has the additional advantage of developing contact between various parts of the banking system and making it easier for the Central Bank to enforce its policy.\(^10\) Thus a link may be established between the two markets and it may also enable the R.S.I. to implement its monetary policy more effectively.

The adoption of purposive monetary policy requires a pragmatic interest rates policy. In developed money markets the gap between the money rates is quite negligible and they do not change from season to season. In India there prevails a vide range of interest rates. Even in the organised sector where one could expect some uniformity, interest rates on different types of loans do not follow any uniform pattern. The


Commercial Banks call - money rates and deposit rates vary from locality to locality and from bank to bank. The State Bank of India's discount rate for three months bill has no functional relationship with the same banks advance rate for demand loans. The rates on the three months treasury bills of Government follow still another course. The yields of the various securities on the stock exchanges have a slightly organic unity, though even here it is far from complete.  

In the Bazar sector or unorganised money market in India, interest rates diverge widely over different areas even for the same types of loans. The rates charged by the money-lenders are still higher and vary from urban to rural areas. Besides, at present commercial establishments have also started accepting deposits. Deposit rates of these establishments are higher than those of banks.

It is clear from the above that the problem of rate structure in India, is that of difference in rates due to lack of integration among the various components of the money market. There is not the same incentive as in a more integrated system, to transfer funds from areas of low to areas of high interest rates. There is certain amount of immobility of funds which is a part of the generalised immobilities that characterises under developed economies.

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The existence of such a diversified structure of rates of interest in the money market testifies the extent of unorganised money market in India. Such a state of affairs leaves the R.B.I. in a very prejudicial position as to the effectiveness of the bank rate and consequent regulation of credit through its policy of rediscounting.

Further we have to realise the limitations under which the bulk economy's producers particularly in the rural areas operate. The income and surplus being low there is no possibility of opening the accounts in banks and co-operatives. Their assets cannot be deemed to be creditworthy as per standard requirements. The consumption and production needs cannot be distinguished in regard to producers who are also self consumers. In such a set-up, the high special overhead costs of organised agencies make it impossible for their operation to percolate to rural areas. Most of the co-operative societies are badly managed and because of intimate link between the State politics and co-operatives, a lot of patronage is involved in loan disbursments. So long as test of viability at the appropriate interest rates is not satisfied by the most of societies, they will continue to be parasitically dependent upon loans from R.B.I. and the Government. It is well known that the co-operatives have not succeeded in mobilising the deposits.

For the present, the bulk of rural economic activities involves hundies and cash and not bank cheques. Tax authorities frown upon such transaction and may not and generally do not, recognise expenses not
made by cheques as admissible. It is true that considerable income escapes taxation. The presumption that by penalising cash transactions one can reduce tax evasion may not be true. But this does come in the way of financing rural production and trade.

In the past the authorities have tried to bring integration by hoping to substitute the markets with cheap funds from the banks. We know that this has not led to integration. On the other hand the opportunities for speculation have increased multifold. Thus if we take into account the funds held for the motive of speculation in commodities we may find that instead of extending and strengthening the areas of control, the authorities have increased the area of operation of unorganised agencies.

Today integration involves a fundamental change in outlook in interest policy. It is clear that if integration is to be promoted, both deposits and lending rates have to be increased substantially and Bank rate must vary frequently and sharply to counteract speculative gains.

We must encourage the development of the real bill market. The development of such a market is very important for healthy feature of our credit system (vide chapter on specialised markets - A case for genuine bill market). Regional Rural Banks with scope for competition must be developed. The overhead cost of organised banking
system which today may amount to more than 5 per cent of deposits is too high for the promotion of deposit business through big banks.\textsuperscript{12} Social equity also demands that operational overheads must have some relation to the poverty of potential savers.

One convenient method would be to establish a new work of Regional Rural Banks and small - town - banks for deposit collection. The regional rural banks can experiment with this scheme. The existing money lending agencies can be brought within the net work.

In fact, today the notion of integration must give place to decentralised competitive financial development. The indigenous bankers have got an element of strength. This should be put to use and must be made a part of the organised sector. A great deal of progress can be achieved if the State Governments are brought in the areas of development of Regional Banks. Actually there is need for transferring the power of licencing of regional banks to them. R.B.I. itself has to shed its metropolitan and centralised character. It can shift its organisation zone-wise and experiment with different patterns of credit regulation. A great scope exists for locational decentralisation of its functions.

As things stand today the R.B.I. has to look to the development of the financial mechanism of the whole country and at the same time it has to tackle the problems of regional and local importance. In the

context of present nature of banking, the R.B.I. has to function as a unitary institution under a federal constitution. So diversified are the regional claims, and so uneven is the economic development of these regions, that it is not possible for any Central Bank much less that of the R.B.I. to evolve any common policy for the development of all the parts of country. In fact, the R.B.I. could never endeavour to assess the possibilities of development of markets on regional lines. No survey has been conducted for the evaluation of latest potentialities of different regions. In the context of the planned economic development of different states, it is now obvious that financial mechanism should be so modelled as to cope with development at the State level. As it is, it is tremendously overloaded institution. As a centralised national institution having broad area to serve and onerous responsibilities to perform, there is no pointed development of financial centres and the regional money markets in the country.

In a country like India with large geographical dimensions, huge population and large number of banking offices, co-operative banks and indigenous bankers it is necessary that there should be "Regional Central Banks" which will be effective with their constituents. The Regional Central Banks, thus established are to be co-ordinated, guided and controlled by a "Central Monetary Board" on the same
lines as the Federal Reserve Board in the U.S.A. A leading banker observes, "there may be five autonomous regional reserve banks co-ordinated by the Central Board, which will evolve policies and take important decisions, the execution of being entrusted to regional banks. Such decentralisation will bring the local management in closer and more intimate contact with the respective regions." This will facilitate not only better appreciation of the local problems and needs but also the development of the desired relationship between the Central Bank and Constituents of the money market.