CHAPTER IV
BANK RATE POLICY OF
RESERVE BANK OF INDIA
Bank Rate as defined by Section 49 of the Reserve Bank of India Act 1934 is a discount rate, namely, the rate "at which it (the Bank) is prepared to buy or rediscount bills of exchange or other commercial papers eligible for purchase under the Act." Owing to the absence of a well-knit bill market, its significance lies basically as the base of the Bank's rate on its lendings. Thus Bank Rate is the official rate in the nature of an accommodation discount rate. The Central Banking Enquiry Committee envisaged the role of the Reserve Bank of India as a bank of accommodation as the 'bank should take all possible steps' to encourage the creation of discount market in India within the shortest possible period with a view to make the Bank Rate, an effective weapon for control of credit in the country. Though the effectiveness of Bank Rate as an instrument of credit control cannot bring
about such affects in India as it would in a well organised money market, it has achieved certain results in removing disparity between the Calcutta and Bombay bazaar rates and in narrowing down the great differences between various rates prevalent throughout the country.

**VARIATIONS IN BANK RATE**

To study the Bank Rate Policy of the Reserve Bank of India it is necessary to assess the changes made by the bank in the bank rate from time to time. During the life time of the Reserve Bank the bank rate has undergone changes only four times—in November, 1935, in mid-November, 1951, in mid-May, 1957 and on January 2, 1963. In the first year of the bank's existence, viz., in November, 1935, the bank rate was reduced from 3½ per cent to 3 per cent. The Government in the beginning of 1946 suggested a reduction in the bank rate but the Reserve Bank did not think it proper due to fear of dangers consequent upon the excessive cheapening of money. Though the Government got away with its plan of converting the 3½ per cent non-terminable loan to 3 per cent in May, 1946, but no change was effected in the Bank Rate. In this manner though in the intervening years, sometimes the Government and sometimes the bank wanted a reduction in the bank rate, but practically no further change in it until November, 1951.

**FIRST CHANGE AFTER II WAR**

On November 15, 1951, the Bank Rate was raised from 3 per cent to 3½ per cent in order to check the continuous expansion of Bank advances. The scheduled banks advances reached the
peak in 1951-52, amounting to Rs. 523.59 lakhs. The raising of bank rate had the immediate effect of making credit dearer, and the money market rates faced an upsurge. The Imperial Bank of India raised the call loan rate on advances of Rs. 5 lakhs and above, to the scheduled banks from 2½ per cent to 3 per cent, and then to 3½ per cent. It general rate for advances was raised from 3½ to 4 per cent, and its hundi rate from 4 per cent to 4½ per cent. The Exchange Banks increased their lending rates all round from 1 per cent to 1½ per cent. The other Commercial Banks also raised their rates generally by about ½ per cent to ½ per cent. There was also a gradual increase in the inter-call money rate which rose to 2½ per cent. As the busy season of 1951-52 got under way advances began to increase and with the growing demand for funds, there was a further hardening of call rate among the larger scheduled banks. The rates were pushed up also by smaller scheduled banks.

The raising of the Bank Rate from 3 per cent to 3½ per cent in September, 1951 and the subsequent open market operation policy adopted by the Reserve Bank of India signalled a definite change in the credit policy of the bank. After a long period of cheap money policy the Reserve Bank assumed a "flexible interest rate" policy in realm of credit control. The raising of the bank rate coincided with the receding phase of the Korean War boom. This helped greatly in bringing down the price level and establishing it by the end of 1952.

But it should not be assumed that the effect of raising
the bank rate would be uniform on the money market as a whole. The unorganised sector of the money market, namely, the indigenous bankers, money lenders and the like who carry on their business mostly with their own funds and who are loosely connected with the organised sector of the money market, will not be affected by the raising of the bank rate to the same degree as the organised market. In India, the effectiveness of the Reserve Bank's Credit controlling weapons are limited to the narrow zone of organised section only.

ANOTHER CHANGE IN THE BANK RATE

The Bank Rate was again raised in mid-May, 1957 to 4 per cent, at which level it has technically remained unchanged. It must be borne in mind that in India, the bank rate, significance lies mainly as a rate on lendings. Leaving aside the rate of advances charged to the co-operative sector, which shall be probed into presently, the lending rates to scheduled banks have undergone some variations. No divergence was there between Bank rate and the advances rate till January, 1952, when, following the raising of bank rate to 3½ per cent in November, 1951, the Bill Market scheme was introduced and the rate of advances under the scheme was maintained at 3 per cent, this was an important element in the promotional aspect of central banking. Loans against Government and other approved securities, however, were made at the new bank rate, i.e. 3½ per cent. In March, 1956 the bill lending rate was raised to 3¾ per cent and, in November, 1956, further to 3½ per cent, making it again equivalent to bank rate.
But for the scheduled banks the effective borrowing rate against
usance bills went up to 4 per cent from 1st February, 1957, as
a result of the raising, by Government, of stamp duty on usance
bills (from practically to one half of one per cent), which the
Finance Minister called "a fiscal measure with a monetary
interest. " Simultaneously, "with a view to avoid discrimina-
tion against borrowing under the bill market scheme", the Reserve
Bank of India also raised its lending rate on advances against
Government Securities to 4 per cent. During the next fourteen
weeks, Bank Rate remained practically unaltered but as already
mentioned, it was formally raised from 3½ per cent to 4 per cent,
shortly afterwards, that is, from 15th May, 1957. From this date,
the Government lowered the stamp duty on usance bills to one-
fifth of one per cent with the result that the effective borrow-
ing rate under the bill market scheme rose slightly to 4-1/5 per
cent, that is, 4 per cent, payable to the Reserve Bank plus 1/5 of
one per cent, payable to Government by way of stamp duty. In
simple words, bill borrowing, which till November, 1956 had en-
joyed a preferential rate, became more costly than other types
of borrowing. This was due to the changed liquidity position of
banks which also experienced rapid growth in deposits. Thus the
raising of Bank Rate, by ½ per cent, was effected in a very smooth
way "designed primarily to minimise disturbance to the money and
gilt edged markets," According to the Reserve Bank's Annual report
Even in 1951 the lending against bills at the old bank rate itself
had softened the rise in the bank rate.
On January 2, 1963, the Bank Rate which was fixed at 4 per cent since mid-May, 1957 was raised to 4½ per cent. Thus the Bank Rate went up by ½ per cent. The official announcement of the Reserve Bank said that the increase "formalises the existing patterns of interest rate."

The Bank Rate increase embodies in a large measure a follow-up action that may have little practical significance. If such a move results in stabilising the general level of short-term rates at 7½ per cent to 8 per cent rather than 6 to 7 per cent the resultant impact on the industrial and commercial community will be profound. It was only recently that the National Defence Bonds redeemable in 1972 were offered on a 4½ per cent basis. The impact of the Bank Rate increase on the response to this loan will not be favourable and New Delhi will soon be confronted with the problem of bringing the rates for Government borrowings in closer alignment with the Bank Rate. There have been vague suggestions that in the emergency posed by Chinese Attack Government should borrow on the basis of cheap money policy. But such proposal altogether ignores the magnitude and incidence of present capital shortage and the vital need to direct scarce resources into the most productive use. The defence effort has had to be superimposed on a major programme of economic expansion, and it would be totally unrealistic to borrow on terms cheaper than the present basis, particularly because the line of economic and defence programmes has become blurred at so many points.

The increase in Bank Rate on January 2, 1963 goesto define the increased attention of the Reserve Bank of India...
towards making the bank rate instrument more useful which so far has not been less effective. A drastic increase of one per cent might have perhaps rehabilitated the bank rate as a potent instrument in the credit regulation scheme. But to the extent that the increase has followed an all-round rise in commercial short-term rates of about $ per cent and it may also lead to a fresh found of increases its impact may not be altogether negligible on expansion of credit.

THREE-TIER -- GRADED RATE SYSTEM

In the last week of September, 1960 a system of graded lending rates was introduced by the Reserve Bank, with the bank rate (the basic rate of lending by the bank) remaining unchanged. The main feature of this scheme is that each scheduled bank was assigned a quota, equal to 50% of the statutory deposits with the Reserve Bank required under Sec. 42 (1) of the Act a rate of 1% above the bank rate i.e. 5% chargeable for borrowing above the basic quota up to the amount equal to the basic quota, any further borrowing above this additional quota being chargeable at a rate of 2% above the bank rate i.e. 6%. The additional reserves impounded by the Reserve Bank over and above the required quota of 2% of time liabilities and 5% of demand liabilities were not included for the calculation of such quota. For borrowing a sum not exceeding the quota fixed the rate was bank rate.
IMPACT ON BANK-CREDIT

Effects of this penal rate system can be judged from its influence upon the total bank credit and the borrowings of the scheduled banks from the Reserve Bank of India.

TABLE SHOWING TOTAL BANK CREDIT AND BORROWINGS FROM RESERVE BANK OF INDIA

1960-61 (Sept.-Aug.)

( In crores of rupees)

<table>
<thead>
<tr>
<th>Period</th>
<th>Total Bank Credit</th>
<th>Borrowings from the R.B.I.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1960</td>
<td></td>
<td></td>
</tr>
<tr>
<td>September</td>
<td>1,128</td>
<td>45.56</td>
</tr>
<tr>
<td>October</td>
<td>1,115</td>
<td>27.53</td>
</tr>
<tr>
<td>November</td>
<td>1,107</td>
<td>19.43</td>
</tr>
<tr>
<td>December</td>
<td>1,147</td>
<td>35.96</td>
</tr>
<tr>
<td>1961</td>
<td></td>
<td></td>
</tr>
<tr>
<td>January</td>
<td>1,213</td>
<td>48.31</td>
</tr>
<tr>
<td>February</td>
<td>1,256</td>
<td>56.63</td>
</tr>
<tr>
<td>March</td>
<td>1,308</td>
<td>76.94</td>
</tr>
<tr>
<td>April</td>
<td>1,316</td>
<td>49.21</td>
</tr>
<tr>
<td>May</td>
<td>1,299</td>
<td>34.05</td>
</tr>
<tr>
<td>June</td>
<td>1,284</td>
<td>19.48</td>
</tr>
<tr>
<td>July</td>
<td>1,256</td>
<td>4.65</td>
</tr>
<tr>
<td>August</td>
<td>1,238</td>
<td>2.11</td>
</tr>
</tbody>
</table>

It is clear from the above table that the penal rate
Graph showing total bank credit & borrowings from Reserve Bank of India 1960-61 (Sept-Aug.)

Scale
1" = Rs. 40 Cr.

Chor's of Rupees

False Base Line

Month
imposed by the Reserve Bank of India had not been very effective in checking either the expansion of bankcreditor borrowings from the Reserve Bank itself. Since September, 1960 when the penal rates were imposed the total bank credit continued to expand. There had also been more borrowings from the Reserve Bank which increased from Rs 46 crores in September, 1960 to Rs. 77 crores in March, 1961. Of course, it did produce its effects upon borrowing with the advent of the slack season. The borrowings during this period began to decline and stood at a very low level of Rs 2 crores in August, 1961. The effect of the penal rates on total bank credit began from March, 1961, and the total bank credit continued to fall upto the month of August, 1961. From March, 1961 upto August, 1961 the total bank credit fell by Rs. 70 crores.

This graded system was adopted by the Reserve Bank in the wake of fairly stringent action through the variable reserves instrument in March and May, 1960 and also extension of selective credit controls to shares; the discussion of which shall be done on a later stage. This step has involved a marked increase in the average rate charged on all borrowings from the Reserve Bank, which is correctly above 5%. With this slab system, the money market in India has been characterised with the practical winding up of the quasi-central banking function of the State Bank of India in acting as a bank of intermediate resort. The lending rates of state Bank to other banks has also been raised from 4% and 4½% to 6% at all larger centres where an office of the Reserve Bank of India is located, and to 5 per cent at other
centres for limited amounts. The lending rate of Reserve Bank has been made more effective by this step.

Although the impounding of additional reserves reduced the liquidity of the banking system, to a little extent, this was neutralised by the scheduled banks much larger borrowing from the Reserve Bank, as a result of which the contraction of bank credit in the slack season was much less than what was deemed feasible and desirable. In the circumstances, the bank had to take some steps to discourage borrowing by banks and nothing was more natural than the raising of central bank credit. Even the stoppage of buying securities would have led to the same situation. Rather than putting up the bank rate straightway, which course appears to have been widely anticipated in financial circles for some months past, the bank decided to introduce a system of slab rates. Some sections of the financial community and the press appeared to have felt that a simple rise in the Bank Rate would have been more convenient and would also have appreciated better. As against this, it is interesting to note that, in Indian conditions, where bank rate changes are regarded as of fundamental significance, as the changes are few and far between, the change in the interest rate pattern had to be brought about as smoothly as possible, particularly since the borrowing programme of Government had just been concluded. An increase in Bank Rate to, way, 5 per cent would perhaps have disrupted the money and gild-edged markets. Besides, up to a point, it is, perhaps, the obligation of the Reserve Bank to provide accommodation to the banking system and if the banks would keep their
resort to the Reserve Bank to modest limits, there is no need why there should be a general and sharp increase in the bank's lending rates. The slab system of lending rates is a flexible arrangement and provides the bank a substantial amount of freedom to have fairly high rates and change the slabs and the penalty rates. This system is without prejudice to the bank's discretion to take action on bank rate, in view of the fact that many other rates in the economy are based on the Bank Rate.

LENDING RATES OF BANKS RAISED

At the same time, a directive was issued by the Reserve Bank, introducing an increase in the lending rates of scheduled banks by a minimum of $\frac{1}{2}$ per cent per annum and to maintain their minimum lending rate at 5 per cent on all loans and advances (without certain minor exceptions, such as inter-bank advances). By average lending rates, was meant the rates as worked out for the year ended 30th June, 1960. As a matter of fact, the actual increase has been higher than $\frac{1}{2}$ per cent. The directive intended to ensure a co-ordinated upward shift in the pattern of lending rates which was already in process in response to the heavy increase in demand for bank credit and was called for atleast partly to curb such boom. Although the raising of the Reserve Bank's lending rates would have led to a rise in the scheduled banks' own lending rates, the bank wanted to make sure that this would happen. This is the first occasion when the bank attempted to regulate directly lending rates. The bank also put a ceiling o
of 2 per cent in respect of the interest paid by banks on deposits maturing in 21 days or having a notice period of not more than 21 days.

**FOUR-TIER SYSTEM OF GRADED RATES**

The graded system of lending was changed with regard to some points by the Reserve Bank of India. By issuing a letter on July 2, 1962 to the scheduled banks the Reserve Bank of India introduced a four-tier system of credit. A letter was issued to bring about certain modifications in the three-Tier system which was introduced in September, 1960 with a view to introducing the banks to achieve a greater measure of self-reliance and reinforce their efforts to meet the growing credit needs of the private and public sectors through more effective mobilisation of financial resources. The changes made in the quota for borrowings from the Reserve Bank announced in September, 1960 on July 2, 1962 are evident from the portion of the latter quoted below:

"Effective immediately, the quota during each quarter will be 25 per cent of the average of the reserves required to be kept by each bank under Sub-Section 1 of Section 42 of the Reserve Bank of India Act during each week of the previous quarter. Borrowing up to 100 per cent of the quota will be permitted at the bank rate, namely, 4 per cent. Any borrowing over this amount up to 200 per cent of the quota (viz, up to 50 per cent of the average of the reserves during the previous quarter) will bear an additional rate of 1 per cent over the bank rate;"
borrowings in excess of 200 per cent and up to 400 per cent of the quota (viz., up to 100 per cent of the average of the reserves during the previous quarter) will bear interest at 2 per cent over the bank rate. Beyond this further limit borrowings will bear interest at 2½ per cent over the bank rate. The system of quotas and additional rates is applicable only to borrowings of scheduled banks under Section 17 (4) (a) and 4 (c) of the Reserve Bank of India Act. The additions to basic quotas of individual banks announced by the bank in terms of its circular letter No DBO Sch. 12644/C. 96-61 dated December 11, 1961 regarding lending to co-operatives and small industries would continue to remain in force and be over and above the quota as set out in this letter.

EMERGENCY MEASURES

The Chinese attack on 20th October, 1962 on Indian frontier created a situation of War time emergency in the country. The Reserve Bank of India immediately realised the situation and on October 31, came out with its own measures for putting a curb on expansion of credit. With an announcement, the Reserve Bank eliminated the four-tier of unlimited accommodation at 6.5 per cent available to scheduled banks with effect from November 1, 1962, there were only three-tiers left and the total accommodation available to any bank was limited to the extent of its statutory reserves. Reserve Bank also announced that "should a bank find itself in a special situation requiring further assistance over and above its ceiling limit", states a Reserve Bank
Press communique, "the Reserve Bank will consider, the grant of such assistance, only after making detailed assessment of the bank's overall position and satisfying itself that the additional accommodation is justified."

The Reserve Bank will charge "a penal rate of interest" for such special accommodations. The rate of such penal interest has not been specified in the communique.

The facility of providing banks accommodation at 4 per cent in excess of their basic (bank rate) quota up to an amount equivalent to the excess of a bank's lending to small industries and co-operatives during each half year over the previous corresponding half year will be withdrawn.

The Reserve Bank proposes to offset the addition to the basic quota of a bank by adjustment in its borrowing quota at the higher slab rates, namely 5 and 6 per cent.

CONCESSIONS ALLOWED

On 15th November, 1962, the Reserve Bank of India reconsidered the restrictions imposed earlier and allowed concessions with regard to advances, in certain cases. A letter of the bank issued to state banks stated that in addition to the basic quota—under three-tier system—"each scheduled bank may be sanctioned for a period of six weeks, beginning November 10, an additional quota, which together with the basic quota, would equal the maximum of the banks' actual borrowing during the last bill market season", -- at an interest of 6.50 per cent per annum.
The Reserve Bank will sanction "appropriate" excess quotas to banks for the balance of the busy season on the basis of estimates of requirements to be submitted by them before the end of the six-week period, that is, before December 8, 1962. This letter stated that such estimates should be formulated by banks in the light of certain adjustments in their advances policy.

**AIM OF POLICY**

The policy is designed to hold the price line and banks should refuse to give advances for hoarding and speculation. Banks have to refuse and recall unsecured (clean) advances, and advances against gold and shares. They are required to channelise credit for "promotion of essential productive effort"—that is, for defence, civil consumption and export.

The decision to raise the ceiling on accommodation and lend a certain excess amount at an interest of 6.50 per cent has been taken by the Reserve Bank in the light of its assurances to banks' last Chairman.

The re-introduction of the fourth-tier of lending does not mean that the Reserve bank has reverted to the four-tier system prevailing till October 31. The difference lies in the fact that the Reserve Bank will not lend an unlimited amount at 6.50 per cent as before. It has pegged its total accommodation to the maximum lent in the last busy season. The relaxation of the Reserve Bank limit will not have a significant impact on banks'
liquidity in the six weeks ending December 8, 1962, for banks are hardly likely to seek accommodation at the penal rate of 6.50 per cent so early in the busy season.

Borrowings of the scheduled banks from the Reserve Bank borrowings amounted to Rs.3.98 crores on November 9, 1962. On the basis of the present level of bank deposits, the banking system (excluding the state Bank), would enter the 6.50 per cent slab only after its borrowings exceeded about Rs.44 crores. This is unlikely to happen between November 8, and December 8, 1962 considering that scheduled banks borrowings touched a peak of Rs. 26 crores in the corresponding period of 1961.

**TWO-TIER CREDIT SYSTEM ADOPTED**

The bank Rate was levered up a half-point from 4 per cent to 4½ per cent on January 2, 1963. Simultaneously, the Reserve Bank announced its decision to telescope the existing three-tier system of lending rates into two-slab system. According to this new two-tier credit facility system, the scheduled banks are permitted to borrow the equivalent of one-half of their statutory reserves kept by them with the Reserve Bank of India, under Section 42 (1) of the Reserve Bank of India Act 1934, at the new bank rate i.e. at 4½ per cent, against the proportion of one-quarter at the old rate i.e. at 4 per cent in the previous three-tier system. The intermediary slab of 5 per cent which existed in the previous system has thus been eliminated.
The amount equal to the other half of their statutory reserves will continue to be available at 6 per cent as before. Banks requiring assistance in excess of their statutory reserves will be accommodated at the Reserve Bank's discretion at a penal rate of interest, which is expected to work out at 6.5 per cent. The following is the portion text of the Reserve Bank's communique:

"With effect from the close of business today (Jan. 2, 1963) the Reserve Bank of India has fixed the Bank Rate at 4½ per cent. At the same time the existing three-tier system of rates charged by the bank on borrowings by the scheduled banks from it has been altered to a two-tier system. A scheduled bank will now be permitted to borrow at the bank Rate during each quarter equal to 50 per cent of the average of the reserves required to be kept by it under Sub-Section 1 of Section 42 of the Reserve Bank of India Act during each week of the previous quarter. Further borrowing for an amount equal to the quota at bank rate will be permitted at six per cent. Banks requiring assistance beyond this limit will be required as at present, to discuss their requirements with the Reserve Bank. Any assistance granted as a result will continue to be at a penal rate of interest."

The change announced on January 2, 1963 formalises the existing pattern of interest rates and simplifies the system of the Reserve Bank's lending rates. The Reserve Bank of India's decision to raise the bank rate and modify the existing three-tier system of rates charged by the bank on advances to scheduled
banks represents a welcome though grievously belated and half-hearted measure to put the monetary and credit mechanism on realistic footing. The result is that the short-term money market has already pushed up its level of rates to 6\(^\frac{1}{2}\) - 7\(^{1}\) per cent. The long-term rates of industrial lending as represented by the rates charged by the major financial institutions have also risen to 7 per cent. The gilt-edged market on its part has reflected the dearer money basis with a marking up of long-term yields to 6\(^\frac{1}{2}\) per cent. The higher interest pattern is unlikely to arrest the natural growth of credit necessitated by industrial development, spurred by the national emergency.

**CONCESSIONAL RATES FOR STATE COOPERATIVE BANKS**

A reference may here be made to the Reserve Bank's short and medium term lending rates to the State Cooperative Banks, which for about 17 years now, have been concessional. Originally, the rate was 1 per cent below the bank rate and the concession was later on raised to 1\(^\frac{1}{2}\) per cent and again to 2 per cent, the latter continuing till 1960 excepting recently when the concession was lowered to 1\(^\frac{1}{2}\) per cent on medium term advances.

**QUOTAS FOR CO-OPERATIVE LOANS**

On December 11, 1961, the Reserve Bank granted certain additional quotas, over and above those fixed under penal rate system of lendings to scheduled banks based on their lendings to small scale industries and Co-operatives. The scheduled banks
were informed on October 31, 1962 that while they would be able to borrow these additional amounts at Bank Rate their quotas in the next higher slab or slabs (viz., 5 per cent and 6 per cent if necessary) will stand reduced by the respective additions. This system will continue; and a bank's quota at 6 per cent will be reduced to the extent of addition to its quota at 4½ per cent on account of lending to small scale industries and co-operatives."

In point of magnitude, the Reserve Bank's lending to the State Co-operative Banks, on average, is smaller than its lending to scheduled banks and this tendency is steadily rising. Thus the average of the outstanding advances in the financial year 1959-69 was Rs. 68 crores to State Co-operative Banks as compared to Rs.19 crores to the scheduled banks. The rational of charging concessional rates to the State Co-operative banks is that the availability of credit to the rural sector is not satisfactory and the rates of interest paid by the ultimate borrowers are inordinately high. The Reserve Bank's advances at concessional rates had undoubtedly helped to bring down the pattern of interest rate in the rural areas, though not to the extent desired. It is hardly necessary to say that, while it is desirable to a particular sector freely in so far as the credit pool is common ultimately with internsectorial flows, the over-all flow of the Reserve Bank credit should be kept under control.

ROLE OF BANK RATE POLICY- A CRITICAL ESTIMATE.

The commercial bills have figured most insignificantly in the Reserve Bank's portfolio and that the amount of borrowing
from the bank by the banking institutions has not been considerable at any time. Such rediscounting or borrowing, as has been done, partakes of the character of casual or distress borrowing. The result has been the comparative ineffectiveness of the bank rate. There have been only three changes in the bank rate in India; the first change effected on November 28, 1935 followed by another change on November, 15, 1951. Another change was effected on May 16, 1957 followed by a graded system introduced in September, 1960 and an increase in bank rate on January 2, 1963. These changes have already been discussed in detail. Though the first change in Bank Rate on Nov., 28, 1935 (reduction from 3½ per cent to 3 per cent) resulted in a similar fall in the Imperial Bank Rate, and possibly in all bank rates, but the bazar rates actually rose to 6 to 7 per cent in December, 1925, after remaining in the region of 5 to 6 per cent for our months ending in November.

In this way there have been four important changes in the Bank Rate of Reserve Bank of India as against eight changes in the Bank Rate of Reserve Bank of New Zealand, thirteen changes in the Bank Rate of South African Reserve Bank between 1922 and 1949 and six changes in the bank rate of Bank of England with the short span of previous five years. It is interesting to note in this connection that the Bank France between 1844 and 1900 changed its Bank Rate III times, compared with 400 changes in the rate of Bank of England; and between 1901 and 1914 the alterations in their rates numbered 10 and 66 respectively.\textsuperscript{2} The Reichsbank

\textsuperscript{1} Annual Report on Currency & Finance (1935-36)
\textsuperscript{2} Palgrave: Bank Rate & the Money Market P. 151
Hantwey: A century of Bank Rate, Appendices I & II.
changed its discount rate 84 times during 1875 - 1900 period. Whatever changes have taken place in the bank rate in India, have not been in a position to modulate the market rates and the credit situation. Stationary aspect of our bank rate or (absence of frequent changes in the Reserve Bank Rate) may be taken as an indication of ineffectiveness of the Bank Rate in India. But the frequent changes in the bank rate are not the decisive proof of its effectiveness. Even in the absence of such fluctuations, the bank rate may be effective and a developed discount market can be brought about. Rather, frequent changes in the bank rate are not liked by the customers and so the banks adhere to the policy of quoting as far as possible, stable rates irrespective of changes in the bank rate. To quote A.F.W. Plumptre "It has been something of a tradition, even a matter of pride that the leading institutions would keep their rates steady in the face of changing circumstances. 1 While, therefore, they may be unwilling to change their rates (following a change in the bank rate), they may nevertheless react by changing in their policy regarding the grant of advances; becoming more liberal at one time than at another. The effectiveness of bank rate, therefore, should be judged from the volume of loans and overdrafts and the cash position of the banks. On this test, the Bank Rate policy of the Reserve Bank, as will be proved shortly, has had a negligible influence over the Indian money market.

The trend of Bank Rate and short-term money rates could be linked by means of an active and well organised money

3. De Kock: Central Banking.
market working on a narrow margin and depending upon the Central Bank for accommodation in times of heavy seasonal strain or intense business activity, as well as by means of traditional conventions and general recognition of the leadership of the Central Bank. The effectiveness of the Bank rate and the rediscounting policy of the Reserve Bank like any other Central Bank pre-supposes the presence of three conditions:

(i) Banks do not possess any prejudice against rediscounting at the Reserve Bank;

(ii) they keep an amount of cash-reserves just sufficient for ordinary occasions; and

(iii) they possess in sufficient amounts those instruments of credit which the Reserve Bank is willing, or is authorised to rediscount.

In case, the banks possess any prejudice against rediscounting at the Central Bank, as in London money market, rediscounting habits may not grow at all. Banks in London have been able to avoid going to the Central Bank on account of the existence of the Discount Market, with its easy access to the Bank of England. But the situation has been different in India. Till the establishment of Reserve Bank, the only alternative source of funds to the banks was the Imperial Bank of India. In India, unfortunately, the commercial banks have intended to regard the Imperial Bank (now State Bank) as their competitor rather than a friend. Public rumour also was apt to associate and from such a rival with embarrassment and difficulties rather than normal banking operations.¹ The banks had even a grievance against the

¹ Q. 12, 263 and Qs. 12, 553-60 Appendices to the Hilton Young Commission Report - p. 509.
Imperial Bank in its priviledged position which enabled it according to them, to undercut its rivals. Bank in India expressed before the Central Banking Enquiry Committee their readiness to go to the proposed Central Bank, whenever their arose the need of rediscounting. With the establishment of the Reserve Bank, therefore, it was hoped that the banks will approach it without any prejudice and will thus help in developing the Discount Market. But as we have already seen, the actual position unfolded an altogether different picture. This was not so much due to the apathy or prejudice of the banks to approach the Reserve Bank for rediscounting as due to their self-sufficient position as to resources and cash-reserves.

FACTORS RESPONSIBLE FOR INEFFECTIVENESS:

In this way the role of Bank Rate in controlling credit has been negligible and no major contribution has been made by it in the field of credit control. Really speaking there are certain factors which go a long way to offset the effects of Bank Rate in India. We may discuss them in this context as under:

UNCONTROLLED MONEY MARKET:

The effectiveness of Bank Rate policy is offset in the absence of a well-knit money market, co-ordinating all sectors of banking structure into one organised whole to pulsating effects initiated by the Central Bank may be passed on to the lowest layers and the remotest corners of the money market.

But the condition of Indian money market is quite reverse. It has been characterised with looseness, haphazardness, and disintegration. Besides, the inadequacy of organised banks, which are concentrated mostly in a few big towns and cities, there are myrades of indigenous bankers, who are out of any control. Broadly speaking, more than 90 per cent of the total borrowings of cultivators is met from non-institutional private agencies.

In India this percentage has a great significance, for borrowings of cultivators are no less important in India, which is an agricultural country. Of these private agencies, money lenders or indigenous bankers constitute 70% - 45 per cent being professional bankers and about 25 per cent being agriculturalist-cum-money lender. 1

The indigenous bankers thus dominate the scene. Their activities are not controlled in any way, and they cannot be because their ways and methods are secret, subtle, and shrowed, not regulated by any rules of accountancy. It is interesting to quote here the words of a Multani banker who wrote expressing their secrecy that "Our business is based on strict privacy audit which greatly hampers our business if we make up our mind to show our account-books." 2 Even in well-knit sections of the money market, the conditions are no better. There are differentials of a very high order in the rates charged by the commercial banks. The difficulty of the Reserve Bank of India, in dealing with credit distribution, does not lie in the multiplicity of the banking units alone. It is aggravated by its diversity and

and range. The Imperial Bank, the Exchange banks, the bigger Indian banks and the Small Scheduled banks, not to mention the hundreds of non-scheduled banks and myraids of indigenous bankers, pose their own problems of relationship; and there can be no common law governs the all. ¹

Thus indigenous section of the Indian money market is, beyond control. The rates charged by them are determined more by convention than by competition. In our rural economy they occupy such a powerful and omnipotent position that any monetary policy of the bank has been rendered ineffective or only successful in part. While inaugurating the All India Shroffs' Conference in Bombay in July 21, 1951, the Governor of the Reserve Bank of India expressed his hope that 'Constructive proposals' to bring the indigenous bankers within the orbit of Reserve Bank will be 'evolved'. These proposals are still in the waiting. But onething that is conceded on all hands, is that credit policy of the Reserve Bank in terms of its Bank Rate as well has been rendered ineffective by the existence of these independent banking agencies.

SELF SUFFICIENCY OF SCHEDULED BANKS:

One of the most important factors contributing to the ineffectiveness of Bank Rate as a credit regulator in India is the self sufficiency of scheduled banks. Banks have ample funds at their disposal, and therefore, the weapon of Bank Rate fails

¹. C.D. Deshmukh: Central Banking in India, A Retrospect pp. 20-21.
in affecting the rates of advances of the scheduled banks. Scheduled banks in India during the long past have provided credit while they borrowed negligible amounts of money from the Reserve Bank to such ends. Huge amount of time and demand deposits with the banks have enabled them to provide heavy loans from their own reserves without having recourse to borrowings from the Reserve Bank. This self-sufficiency of scheduled banks in India is proved by the meagre borrowings from the Reserve Bank as is evident from the following table:

(\text{Lakhs of Rupees})

<table>
<thead>
<tr>
<th>Year June - May</th>
<th>Credit given by scheduled Banks (1)</th>
<th>Borrowings of scheduled Banks from R.B.I. (2)</th>
<th>Percentage of (1) to (2)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1955-56</td>
<td>632,46</td>
<td>24,51</td>
<td>3.9</td>
</tr>
<tr>
<td>1956-57</td>
<td>781,64</td>
<td>63,45</td>
<td>8.1</td>
</tr>
<tr>
<td>1957-58</td>
<td>890,80</td>
<td>44,58</td>
<td>5.0</td>
</tr>
<tr>
<td>1958-59</td>
<td>899,17</td>
<td>17,81</td>
<td>2.9</td>
</tr>
<tr>
<td>1959-60</td>
<td>987,47</td>
<td>19,42</td>
<td>2.9</td>
</tr>
<tr>
<td>1960-61</td>
<td>1,160,19</td>
<td>43,01</td>
<td>3.7</td>
</tr>
<tr>
<td>1961-62</td>
<td>1,278,57</td>
<td>21,68</td>
<td>1.7</td>
</tr>
</tbody>
</table>

The above table shows the total credit given by scheduled banks and their borrowings from Reserve Bank from 1955 to 1962. During this period the credit provided by scheduled banks has ranged between Rs. 69 crores and 128 crores while their borrowings
have never gone above Rs.64 crores. The maximum extent of borrowings is 8 per cent of the credit provided by the banks and during the past year it has further been reduced to merely two per cent. This proves the self-sufficiency of scheduled banks in providing credit. Even in 1951-52 ratio stood at bare 4 per cent. Banks have already huge reserves with the Reserve Banks over and above what is required under Sec. 42 (1) of the Reserve Bank Act. This further goes to certify the independence of scheduled banks. As the scheduled banks rarely depend upon the bank to enhance their cash reserves, their lending rates are least affected by the bank rate. In this way the role of bank rate in Indian money market in contraction or expansion of credit has been least effective, and the role of bank rate in controlling credit has not been sensitive and noteworthy.

**DIVERGENT POLICIES OF THE IMPERIAL BANK**

*(STATE BANK OF INDIA)*

In addition to the unique status of the Imperial Bank as to resources and cash position withholding it from the use of trade bills and preventing it from approaching the Reserve Bank for rediscounting, the rates policy of the Imperial Bank had been in contrast with that of Reserve Bank. The Imperial Bank attempted, to use its strong financial position to come out as an important lender in the money market, thereby withholding the banks from approaching the Reserve Bank for the purpose of rediscounting their portfolios at the discount rate of the Reserve Bank.
Before the Reserve Bank actually announced its first official Bank Rate at 3¼ per cent on July 4, 1935, the Imperial Bank announced in June, 1935 its scheme to advance loans against Government Securities at the rate of 3¼ per cent. In July, when the Reserve Bank made its official announcement of Bank Rate at 3½ per cent, the Imperial Bank reduced its call loan rate to 3 per cent and agreed to extend secured loans on a call money interest basis. There is reason to believe that this was done so that the banks taking advantage under this scheme may not approach the Reserve Bank for rediscounting their trade bills at the Reserve Bank Discount Rate, which was obviously higher by half-per cent.

When the Reserve Bank lowered its Bank Rate on November 28, 1935 from 3½ per cent to 3 per cent, the Imperial Bank in contrast to the policy of Reserve Bank announced that it will extend loans against Government or authorised securities, gold or silver bullion or against documents of therto, at an interest rate known as Imperial Bank Advance Rate of 2¾ per cent. At the same time, the Imperial Bank agreed to charge interest only for the actual period for which the loans were due. The Imperial Bank, thus, succeeded in attracting the borrowers, who would have otherwise approached the exchange banks or other commercial banks. This caused the inter-bank call money rates to move simultaneously with the Imperial Bank Advance Rate so well that the Imperial Bank could well fix up its call Rate at 2 per cent and its Advance Rate at 2¾ per cent. Thus the Imperial Bank could secure
a controlling influence in the supply of funds to the call-loan section of the organised sector of the Indian Money Market.

As against this policy of the Imperial Bank to win the call loan market, the Reserve Bank had to remain aloof from it for reasons of its policy of non-competition with the commercial banks in the country. The Reserve Bank, being a Central Bank of the country, was prevented from entering directly into call loan section of the money market. Though there was a statutory power with the Reserve Bank to make direct loans and discounts without the mediation of scheduled banks, it did not exercise this right for reasons, that its Bank Rate would have amounted to a 'Penalty Rate' to the banks, since it was cheaper for them to approach the Imperial Bank for loans at the Imperial Bank Advance Rate which was for all practical purposes, lower than the Discount Rate of the Reserve Bank of India.

Such divergent policies of the Imperial Bank and the Reserve Bank were more common between 1935 and 1939 when the demand for funds tended to concentrate on the 'counters' of the Imperial Bank, and when these counters signalled 'Red' the Reserve Bank was approached. This attitude of the Imperial Bank prevented the important sections of the money market from approaching the Reserve bank, who, therefore, could not develop an organised discount market in India.