## The Indian Money Market

by J. S. G. Wilson

In general terms, the Indian banking system may be divided into two main sectors: that which concen- trates itself with commercial banking (as that term is commonly understood in Western coun- tries); and that which derives from indigenous banking practice, with a tradition going back many hundreds of years. It would be wrong to suppose that these two sectors are wholly unconnected with each other, but the links which exist are somewhat tenuous and the complete integration into a unified system has yet to be achieved. Underlining this dichotomy is the restricted role of the cheque. In any extensive sense, it is still true to say that the banking habit is relatively undeveloped and the use of banks tends to be confined to the larger commercial centres. Banking in its sophisti- cated forms is very much an urban institu- tion in India, though even in the cities and towns much business is transacted by indige- nous institutions which are not banks in the accepted sense of the word. At the same time, the cheque as an instrument of commerce is supple- mented in a very important way by dig- nified credit arrangements. Even so, for much of the rural population, which is largely illiterate, organised banking arrangements scarcely exist. In consequence — and looking at the country as a whole — we find, first, that the use made of bank credit is relatively re- stricted; second, that the majority of transactions involve the direct employment of notes and coin; and, third, and even more obviously beyond the influence of banking institutions, that many transactions are still effected on a barter basis. Superimposed on all this is the hoarding habit, which appears to provide an almost bottomless pit for the absorption of gold and silver. This is the background against which to view the organisation of banking in India.

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banks; it was accorded the sole right to issue notes and was required to manage the note issue; it was to regulate ... the keeping of (banking) reserves with a view to securing monetary stability ... and generally to operate the currency and credit system of the country to its advantage; and it was under an obligation to buy and sell overseas exchange for the purpose of maintaining the external value of the rupee. Grouped around the Reserve Bank and forming the body of the 'central money market,' we have the commercial banks. These may be divided into two main groups — the 'exchange banks' and the Indian joint stock banks (both 'scheduled' and 'non-scheduled'). The exchange banks (of which there are now fifteen operating in the country) constitute the oldest and most homogeneous group of banks in India. They include such famous names as the Chartered Bank of India, Australia and China; the National Bank of India; Lloyd's Bank; the Mercantile Bank of India; and the Fleming and Shanghai Banking Corporation. These banks have been foreign (i.e. non-Indian) in origin and their methods are primarily derived from British and particularly Scottish experience. At times, and in certain quarters, they have been regarded with some suspicion; but their strength in periods of crisis appears more recently to have created a new respect. Every confidence is now placed in their ability and willingness to meet fully their responsibilities to the community. They are not, of course, confined in their activities to India alone, but this country (with Pakistan) is one of their most important spheres of operation. Within India, the offices of these banks are concentrated mainly in Bombay and Calcutta, with minor groupings in Delhi, Madras, and Kamarp. The exchange banks specialise in the financing of foreign trade, in which they still have a near-monopoly of the better-class business (1). They also play some part in the financing of internal trade, in order to assist the movement of goods between up-country centres and the ports, but their general banking business is related as far as possible to the auxiliary financing of the export and import trades. Of all the 'Indian' banks, as the non-exchange commercial banks are called, the Imperial Bank of India is the largest and most powerful. It was constituted in 1921 as a semi-public institution by amalgamating the three Presidency banks in Bombay, Calcutta, and Madras. It fulfilled the functions of an inter-necentral bank until 1935, when the Reserve Bank began its operations. It has a network of branches and pay offices covering every town of commercial importance in India (besides continuing important services in Pakistan). As agent of the Reserve Bank of India, it still carries out part of its former official functions. Since 1935, when the Reserve Bank was established, it has conducted a general banking and foreign exchange business similar to the other commercial banks, and it is still an important lender to them in the local money markets of Bombay and Calcutta. Apart from the Imperial Bank (which is in a special category), the biggest of the Indian commercial banks is undoubtedly the Central Bank of India. It is followed in order of size by the Bank of India, the Punjab National Bank, the Bank of Baroda, the United Commercial Bank, and the Allahabad Bank (now a subsidiary of the Chartered Bank). These are followed by the still large but now smaller banks, though immediately below them will be found banks which are almost as big and there is, indeed, an almost uninterrupted gradation downwards to banks which are quite small. To be 'scheduled,' a bank must have a paid-up capital and reserves of at least Rs. 5 lakhs (approx. $3,750), but this scarcely provides the hallmark of security. All the larger banks have a network of branches, but these are somewhat unevenly distributed, with a heavy concentration in the larger centres. As many as 800 (out of a total of about 3,600) were situated in thirteen principal cities and towns, and this has led to much unnecessary overlapping and to a good deal of competition, both for deposits and advances. The activities of the commercial banks follow a fairly uniform pattern. All the larger banks accept deposits both on current account and as fixed (or time) deposits (though some small banks accept fixed deposits only and do not hold current accounts at all). Most banks keep savings bank accounts (subject to limited drawings by cheque); the exceptions being the majority of the exchange banks. Usually, a nominal rate of interest is paid on such current accounts as to maintain the required minimum balance. Fixed deposit rates vary with the term for which money is fixed. Accommodation is made available by means of loans, cash credits, overdrafts, or the discount of bills. Loans are made in fixed amounts and are repayable in arranged instalments, while overdrafts are a more elastic type of lending. In the latter case, a 'limit' is agreed upon to which the account may be overdrawn and, although the overdraft is technically repayable on demand, it may be allowed to run on indefinitely. The 'cash credit' is really a special form of overdraft. It is an advance made in overdraft form to finance the purchase of stocks. Though theoretically repayable on demand, in practice the cash credit is allowed to run for 6 or 12 months. The object is to provide working capital on a seasonal basis and it is, in effect, an advance against a pledge or hypothecation of goods. In all cases, a certain margin of security is, of course, required. 'Joint and several loans' — another form of lending — are a special feature of Indian banking. They are due to the fact that security is taken on two signatures in promissory note form, though again such accommodation may run on for a period of months. Elasticity can be provided by successive renewals. All 'joint and several loans' are restricted by 'limits' to the accommodation they can seek in this way. Another specialised form of lending is found in Calcutta, where the banks normally provide finance to the jute industry against 'jute delivery orders.' The business is subject to a monthly settlement, though orders which are retired may be replaced immediately by new ones. The so-called 'demand hundi' is also treated as an 'advance,' though the document is drawn in bill of exchange form. They are used primarily to finance trade between up-country centres and the ports, the usual procedure being to draw sight bills for this purpose and then to secure cash credit accommodation to cover the holding of stocks on arrival. Usually, there are no supporting documents, though in some cases railway receipts or a bill of lading may be attached. Bills are used primarily by the exchange banks as a means of financing exports and imports. These bills are discountable in London and do not come on to the Indian money market. In addition to the London bill (which caters for overseas commerce), a good deal of internal trade is financed by means of the unsecured 'hundi' — the true 'hundi.' This is made out in promissory note form, payable to many days after date. Normally, days of grace are allowed. A 'hundi' is made by a small Indian house in favour of a Multani banker, who discounts it (at a rate up to 9 per cent in Bombay and Calcutta) and thereby becomes the lender. Ordinarily, no value will have been received and the transaction will be precisely of an 'accommodation' character. Usually, the Multani banker then endorses the hundi and, by arrangement through a hundi broker, re-discounts it with a scheduled bank at a rate of 2 to 4 per cent per annum. The Multani banker, or 'shroff,' has limits (often with several banks) up to which he may expect his hundis to be discounted. It is in this way that the Multani banker acts as an intermediary between the joint stock banks and the small trader, about whose creditworthiness the banks will not normally have any detailed information. Only four or five of the scheduled banks discount the true hundi and of these the Imperial Bank does by far the largest business, with the Bank of India and the Central Bank of India doing the bulk of the remainder. Bills discounted now represent no more than 3 to 4 per cent of total accommodation granted by the banks, due (it is said) to the less expensive character and more convenient form of borrowing by way of overdraft or cash credit. The bulk of the advance business — 68 per cent — is done by the Indian scheduled banks. The exchange banks are responsible for 35 per cent and the non-scheduled banks for the rest. The remaining 5 per cent of bills discounted represent between 45 and 59 per cent of total deposits which compares with 55 to 60 per cent for investments. (For non-
II

As has been indicated, joint stock banking in India is concerned primarily with an urban demand, though even in the cities and towns there also exist indigenous institutions, which cater for the many small manufacturers and traders. These may borrow by way of mortgage or by means of hundis. A good deal of the indigenous banker’s business, however, derives from up-country trade. Indeed, it has been estimated that the indigenous bankers finance nearly 90 per cent of India’s internal trade. Nevertheless, it is in the rural areas that the indigenous institutions find most scope for their activities. India is still primarily an agricultural country and her social life is therefore based on her village communities. Hence, the importance of indigenous institutions. The latter may be roughly divided into the indigenous bankers and the moneylenders, but the two groups merge one into the other. The banker, however, generally supplements his resources by accepting deposits from the public, while the moneylender trades primarily on his own capital, though he may raise additional funds by borrowing from other institutional lenders. Generally speaking, the indigenous banker combines banking with other forms of business. They range in size from firms which are little more than petty moneylenders to substantial “shroffs,” who carry on a large and specialized business, which at times exceeds that of some of the scheduled banks. It has not been their practice to publish balance sheets, and they are disinclined to introduce modern methods into their business, which have been carried on for centuries in accordance with an established tradition. Indeed, those who undertake this type of business will usually be found to belong to certain castes or communities, such as the Multanis or Marwaris. The Multanis are a wealthy community, and they own their own resources. Their headquarters was formerly in Shikapur (now in Pakistan), but they have now spread all over India, concentrating their activities in the cities and towns. They borrow from certain of the joint stock banks, which they regard as the appropriate source of their marginal finance. In addition, the Bombay and Ahmedabad shroffs lend money amongst themselves at comparatively low rates of interest (3½ to 6 per cent). The Multanis restrict himself to his banking business (primarily a hundi business) and regards himself as prohibited by convention from accepting the risks of trade, which would only serve to multiply his lending risks. The Marwaris, on the other hand, are altogether different. He is a merchant banker. He deals as a merchant, lends money, and also does a hundi business. Usually, he lends against goods by way of pledge supported by a demand promissory note or umaice mundi. He also accepts a mortgage, either as primary or collateral security. The Marwari bankers prefer to rely on funds from within their own community, but they also accept deposits. Furthermore, the popularity in both Bombay and Calcutta of the “Marwari loan” (as borrowing from the banks on a joint and several promissory note is sometimes called) suggests a growing dependence on bank finance to cover the marginal needs of the busy season. The fact that indigenous bankers are drawn from banking castes or communities accounts for the influence of tradition on their methods. The indigenous banker is brought up to his calling. Generally speaking, he receives no special banking education. He draws on the experience of the past, both that of his firm and latterly his own. From the point of view of the borrower his chief virtue is the absence of formalities and delays. Besides this informality, the indigenous banker is accessible. His lending policy is flexible and, though he may appear to take more risks than his joint stock counterpart, his closer personal knowledge of his customer to a large extent offsets a measure of safety which is still available to larger institutions. The joint stock banks, on the other hand, investigate the nature of the security much more closely and, in any case, their managers cannot have the same margin of discretion as the small man.

As a general rule, it is not practicable for the indigenous banker to establish direct business relations with the agricultural, though indirectly he may assist in the finance of agriculture by making funds available to local sówkars (or moneylenders). Also, by lending to grain merchants, indirect help is given to agriculture by financing the trade derived from it. But, for many years, agricultural credit facilities were provided almost entirely by the village sówkars or bání (i.e. by local moneylenders). The Indian peasant, or rútu, was his chief customer. These small farmers had little credit to offer and no joint stock bank, even if it had a branch nearby, would go the lengths they did. Where liquidity was the main consideration, the small landholder with his crop only ready for harvest after about eight months could scarcely expect to borrow from the commercial banks. In any event, a branch of a joint stock bank is a rare phenomenon in rural India. Hence, the moneylender had for long been an indispensable adjunct to village life. But it became a matter of general comment that, although most accommodating in providing finance for all purposes (marriage and funeral loans were probably the most important of the non-productive types of borrowing), relations between the moneylender and the villager steadily deteriorated over the years. Formally, the moneylender was restrained by various conventions and by public opinion, but with the introduction of Western legal arrangements the tendency was for these restraints to weaken and for the letter of the law to be enforced. In this respect, the appalling illiteracy of the peasant played right into the hands of the man on whom he so vitally depended for his finance. However, the balance of blame was by no means all on one side. It was not unknown, for instance, for a rútu to hypotheicate his crop to one person and then quietly to sell it to another. The moneylender retaliated by taking bonds for larger amounts than had actually been lent (and this too was not unpractised) and he regarded this as merely a regulation of his dealings such that he indemnified himself against risk of loss. It is true that he charged usurious rates of interest, but there were often wide discrepancies between the rate of interest stipulated in the contract and that which he was finally able to collect.

The methods of business of the urban moneylender were almost the same as those of the man operating in the villages, except that the urban moneylender often advanced on the basis of hundis and his operations were on a larger scale. He, too, was accustomed to combine the business of moneylending with ordinary trading.

Over a period of years, various attempts were made to regulate the activities of the professional moneylenders and to restrict the worst abuses. But ignorance of the law, illiteracy, and the ease with which loans could be had from so many sources, made regulation ineffective. Latterly, however, the legislative requirements have been made much more
stringent and, even more important, the nature of these provisions has become more widely known. The latter has been the virtual disappearance of the professional moneylender from many areas. Taking into account the risks involved, it has no longer seemed worth his while to operate under the new provisions. He has therefore chosen to change his calling and to become a merchant or trader, though probably he still carries on an illicit moneylending business on a restricted scale.

The decline in the importance of the professional moneylender has had two effects. First, a vacuum has been created which existing institutions have not been able to fill and there is in consequence a great dearth of credit in the villages. It has been estimated that the cooperatives, for example, only cater for from 5 to 10 per cent of the financial requirements of the rural areas and, even where their services are available, they are not nearly so ready to lend. They investigate the ryot's affairs more carefully than did the sowkar; they require security and adequate arrangements for repayment, whereas the sowkar used to lend with questions asked and repayment was often not insisted upon, provided the interest was duly met. As a result, the villager today finds borrowing difficult and suffers much inconvenience. Second, and because of the villager's insistent demand for accommodation, the non-professional moneylending groups, which have always operated to some extent, are increasing in size. This too is not uncommon -- even in villages where cooperatives exist -- for the larger landowners and wealthier ryots lend to the poorer members of their community, frequently at high rates of interest which the borrowers are quite prepared to pay.

As has been mentioned, there are in existence certain links between the commercial banks and the indigenous institutions, but so far as the smaller indigenous bankers and moneylenders are concerned they are still very indirect. The Reserve Bank has already attempted to bring the indigenous bankers into more direct contact with the central money market, though with somewhat indifferent success. Recently it offered to supply indigenous bankers facilities of direct discount and advances against Government securities, as well as remittance concessions, subject to their shelving their non-banking business, maintaining proper books of account (which would be open to the Bank for inspection), and the filing of periodic statements similar to those supplied by the scheduled banks. But the indigenous bankers were not prepared to accept these conditions and preferred to continue the old arrangements whereby they received accommodation from the Imperial Bank and other scheduled banks. Nevertheless, the Reserve Bank left its offer open and remained ready to take up the matter again, if the indigenous bankers did decide to conform with its conditions or could suggest any other practicable alternative. More recently (1957), the Governor of the Reserve Bank took the opportunity of addressing a conference of indigenous bankers meeting in Bombay in order to state the Reserve Bank's views and there are signs that in the near future it will make an even more determined effort to secure greater integration. As a preliminary step, it has embarked upon an India-wide survey of indigenous credit arrangements and it is hoped on this basis eventually to modify considerably the existing arrangements.

III

Supplementing the work of the indigenous institutions are the several species of co-operative banks. These present the same problem as the two main links (the other being the endorsing shroff) between the sophisticated institutions of the central money market and the credit needs of both the rural village and the smaller artisans of the towns. Attempts have been made in recent years -- by formalising relations between the provincial co-operative banks and the Reserve Bank -- to strengthen this link, but the integration is not yet by any means complete. Second, it was intended that the primary co-operative societies should provide credit facilities in direct competition with and as an alternative to the moneylender.

The main function of the agricultural co-operative societies has been to supply rural credit and to educate the farmer in the practices of co-operation and thrift. More recently, there has been a shift of emphasis to the multi-purpose potentialities of co-operation, such as the development of marketing and procurement facilities. From the depression of the early thirties to the outbreak of war in 1939, the progress of the movement was rather discouraging, when compared with the pre-depression period. During the war, however, the position improved, as was reflected in the increase of working capital from Rs. 106 crores in 1939-40 to nearly Rs. 164 crores in 1945-46 (Rs. 1 crore equals £125, 750,000 approx. in 1955-56). But the increase in working capital, substantial though it appeared to be, was not in proportion to the war-time inflation, due perhaps to the societies' own disinclination to augment funds unduly at a time when the demands of borrowers were decreasing. Another not unimportant reason may well have been that, once the farmer cleared his more burdensome debts out of his increased war-time earnings he lacked the incentive to save further and soon lapsed into his traditional habits of improvidence. As a result a unique opportunity was lost in not augmenting working capital by an expansion of members' deposits. Since the war, there has been some increase in advance to agriculture due substantially to the rise in working costs and the demand for improvement loans. Indeed, the Rural Banking Enquiry Committee, which reported in 1950, referred to the experience of considerable stringency in rural areas and stated that the co-operative institutions are now faced with large demands for funds which they are unable to provide. Further, as a result of the compulsory scaling down of agricultural debt and the fixing of instalments in which the adjusted debts are to be repaid, the normal sources of finance have dried up and the problem of making adequate provision for the needs of the adjusted debtors and other creditworthy agriculturalists has become urgent.

The legislative basis for the development of co-operative banking was provided by the various provincial Co-operative Societies Acts, dating from 1906. The foundations of the system are the village or "primary" societies, which are generally linked with "central banks". These, in turn, are affiliated with the provincial banks. A village credit society can be formed by the association of a minimum of 10 members, who then apply for registration. Where the majority are agriculturists and the object is "the creation of funds to be lent to its members", the liability of members is unlimited. The internal resources are derived from entrance fees, members' deposits, and surplus assets held in reserve. External assistance is obtained from "central" and provincial banks, and from the Government. Accommodation is also available under certain conditions, from the Reserve Bank of India. These funds are then lent out to members at moderate rates for current and short-term purposes. The use to which loans are put should be strictly productive, but loans for non-productive purposes which are "necessary and unavoidable" (e.g. marriage loans) may also be granted from time to time (though with due care) to prevent a member seeking accommodation elsewhere at exorbitant rates of interest. The repayment of loans depends upon the price of the agricultural produce; this, in turn, depends upon the price of the agricultural produce; this, in turn, depends upon the price of raw materials and the size of the crops. The period of repayment, as a result, varies from year to year.
monies were then usually lent short-term to the primary societies, though latterly some of the central banks have undertaken a commercial banking business as well, as a means of employing surplus funds. However, commercial banking strictly lies outside the sphere of the co-operatives and, while certain authorities are in favour of its extension, it is frowned on by the Reserve Bank itself. Lending funds to village societies is regarded as the main function. However, such lending might lead to embarrassing situations. Money might have been lent to one village and would not therefore be available to another. In these circumstances, co-ordination of provincial finance and supervision of the central banks themselves became necessary, if money was to be obtained on reasonable terms. This co-ordination was supplied by what were called provincial or "apex" banks. (In districts where there were no central banks, a provincial co-operative bank would provide the necessary facilities direct to the village societies.) In this way, a federal structure was provided, though it was not always availed of.

An attempt to meet the long-term requirements of agriculturists has also been made by establishing land mortgage banks, but such banks are few in number and of comparatively small resources, except in Madras.

In addition, there are non-agricultural societies called "urban" banks. These cater for the needs of small traders, artisans, em- ployees, and Government servants. This branch of the movement is concerned with a much smaller population than the agricultural societies, but from the point of view of working capital and the amount of business turnover it has definitely reached larger proportions.

More success has been had with the attempt to link the co-operative banks to the central money market than attended the Reserve Bank's efforts to bring the indigenous bankers into closer contact. Thus, in January, 1948, the Reserve Bank proposed a scheme for extending financial accommodation to the co-operative central banks through the provincial co-operative banks, for the purpose of financing seasonal operations, or the marketing of crops, at special rates of interest. Under this scheme, it was proposed to grant a rebate of up to 1 per cent to provincial co-operative banks re-discounting agricultural bills with the Reserve Bank, provided the benefit of the rebate was passed on to agriculturists. Later, as a special case and on an experimental basis, this rebate was raised to 1½ per cent. This was in addition to the existing arrangements under which accommodation was granted to provincial co-operative banks against Government securities. At first, very few applications were received, but gradually the system gained in popularity and the Bank was approached with increasing frequency. During the four years ended June, 1947, the provincial co-operative banks drew only Rs. 32.5 lakhs from the Reserve Bank. In the year ending June, 1948, the Bank sanctioned credit limits to the extent of Rs. 67.70 lakhs and for the following year Rs. 180.25 lakhs, and applications were much heavier than those actually granted. This practice has now become an established part of agricultural finance and, besides making cheaper credit available to the co-operatives and their clients, it has had the effect of linking the co-operative banks more directly to the central money market and has assisted in the development of a more unified system.

IV

So far, the discussion of the structure of Indian banking has been limited to its two main sectors — on the one hand, the commercial banks, and on the other, the indigenous and co-operative institutions. Little has been said about the relations between the two. In certain respects, these two sectors are relatively distinct, but there is, of course, some sort of connection between the several types of activity described and these links have been forged most obviously in the money markets of India's main commercial and financial centres. In this connection, it is sufficient to concentrate on the financial organisation of the two main centres — Bombay and Calcutta. Calcutta is still by far the larger, but Bombay has grown steadily in size, and both are centres of primary and commerce, with developed stock exchanges. Both are major ports. Bombay possesses two leading markets in bullion and cotton, while Calcutta deals in considerable quantities of jute. Madras is much less highly developed than the other two and tends to follow the lead of Calcutta, though it also has connections with Bombay. Banking in Madras is rather a provincial by comparison with the main money markets. Interest rates are rather higher and less competitive. The call money market is scarcely a true market and inter-bank lending is arranged by direct contract. Nor is Madras a true "centre", since much of its business is done on an agency or branch basis for firms in Bombay and Calcutta. The volume of transactions does not permit of the same degree of specialisation as we find in the two more developed markets.

In essence, a money market is a place where the borrowers and lenders of short-term funds are brought together. It is usual to think of the Indian money market as being "undeveloped." This may well be true, but it is wrong to ascribe this lack of development mainly to the absence of a discount market. A money market must be a product of its environment and simply because certain markets have been built up on the basis of particular classes of business is no reason for believing that all money markets must follow the same pattern. Even in the absence of a discount market, there may still be in evidence a system of organised relationships and a specialisation of function, similar to — though not identical with — those characteristic of money markets elsewhere. Indeed, it would seem that the weakness of Indian market arrangements lies in the looseness of its arrangements and its lack of integration rather than in the absence of particular specialisation.

The money markets of Bombay and Calcutta may be divided into two main sectors — along the lines of our earlier analysis. On the one hand, we have the "central money market", which (apart from the Reserve Bank) includes the exchange banks, the Imperial Bank, and the other Indian commercial banks; and, on the other, we have the indigenous market, which consists of a group of banca fori, each following different business practices and a different structure of rates. Within both these main divisions, quite a high degree of specialisation has developed, including some provision of facilities for the flow of funds between them. The chief weakness lies in the links between the main sectors and, until these have been considerably strengthened, further integration will be difficult.
busy season than when business is slack. Thus, there tends to be a decline in demand (and in rates) in May or June, with a rise again in November or December. The influence of seasonal demand is paramount, but short-term factors may result in day-to-day fluctuations.

Thus, heavy Treasury bill maturities may cause funds to be in surplus for a day or so and depress the rate, or a heavy demand for funds to finance speculative dealings on the stock exchange, or the bullion or commodity markets, may drive the rate up. In the main centres, therefore, the call money market is both developed and sensitive to changes in the conditions of overall liquidity.

On the other hand, the bill market, as it has existed for many years, has been a much more dependent phenomenon. All the principal banks in India and, in particular, the exchange banks, discount approved bills and there is a degree of specialisation in the types of bills dealt in, but, until the recent experiment (described below), there was no true market in India for further dealings in these bills. Either bills discounted were carried on the book not, indeed, until maturity, or — at worst — bills with export bills — they were rediscounted by the exchange banks in the London market, which procedure served the interests of economy. Rediscount facilities existed both at the Imperial Bank (which, for some years after the establishment of the Reserve Bank, provided the bulk of rediscount facilities, since its rates were lower than those available at the central bank) and at the Reserve Bank, but this was more in the nature of last resort accommodation, with the Imperial Bank serving as a kind of intermediate lender of last resort. The market was therefore dependent in two senses: (a) on London; and (b) on a direct relationship with the lenders of last resort. These arrangements were not without permanent or regular results which arose due to the somewhat narrow criteria on which approval for rediscounting was based and the remedy has therefore been sought in widening the range of eligibility.

Over recent years, the scheduled banks have normally provided themselves with additional funds for meeting their seasonal requirements either by a sale of securities to the Reserve Bank, or by borrowing from the Reserve Bank against Government securities. This system had obvious limitations and the Reserve Bank therefore decided (in January, 1953) to create a bill market. This had been in contemplation for some time and the experimental scheme was finally evolved in consultation with representative bankers in Bombay and Calcutta. The Reserve Bank was already permitted under its Act to make advances to scheduled banks against the security of unance promissory notes, or bills drawn on and payable in India and arising out of bona fide commercial or trade transactions bearing two or more good signatures, one of which had to be that of a scheduled bank, and maturing within ninety days from the date of the advance. Under the new scheme, advances will be granted to scheduled banks in the form of demand loans on the execution of demand promissory notes supported by unance promissory notes drawn on banks having deposits with the Reserve Bank and within ninety days of the date of the advance. It was proposed that advances by way of demand loans against the security of eligible bills would be made at the offices of the Reserve Bank in Bombay, Calcutta, Delhi, Madras, and Kanpur in respect of advances granted by scheduled banks anywhere in India. But, before extending credit, the Reserve Bank would take into account not only the nature of the security offered, but also the manner in which the business of the bank concerned was being conducted, and the Reserve Bank might refuse to accept the bills of any particular scheduled bank without assigning a reason. In order to encourage the rapid development of such a bill market, it was that these advances should be made at a rate 1/2 per cent below Bank rate, though naturally the Reserve Bank reserves to itself the right to raise the rate at its discretion.

Bank rate is now 3½ per cent (having been raised from 3 per cent a few months last November). The attractiveness of the new arrangements is underlined by the competitive nature of the Reserve Bank's present offer, as compared with the terms now available from the Imperial Bank, whose call rate for loans to scheduled banks against Government securities is now 3½ per cent for loans above Rs. 5 lakhs (this is the rate which most nearly corresponds to Bank rate), while its burden rate (i.e., the rate at which it discounts first class three months bills) is now — at 4½ per cent — one per cent higher than Bank rate. As a further inducement to banks to help create a bill market, half the cost of the stamp duty incurred in converting demand bills into time bills will be borne by the Reserve Bank. As the main object of these proposed advances is to relieve seasonal stringency, the minimum limit for an advance which a bank may take from the Reserve Bank at any one time has been provisionally fixed at Rs. 25 lakhs. Individual bills tendered by scheduled banks to the Reserve Bank for similar advances must be not less than Rs. 1 lakh. In the initial stages, it was foreseen that some delay might be some delay in sanctioning advances on the new basis, because the Reserve Bank would have to make adequate enquiries in order to safeguard its position. If, however, a scheduled bank required cash in advance, it could still get it against Government securities at the Bank rate, pending the completion of the enquiries. It was hoped that at the time this scheme was introduced that with greater experience in its working it would be possible to simplify this procedure. It is, of course, too early as yet to comment usefully on the manner in which the scheme is working out.

Treasury bills deserve separate mention. These are short-term Government securities, issued for meeting Government requirements for supplementary finance, usually with a currency of three months being rediscountable with the Reserve Bank and generally issued during the slack season. They provide an ideal form of investment when the surplus funds of the banks. Government of India Treasury bills, which constitute the bulk of those available, are issued weekly by public tender through the Reserve Bank. In addition, a 'intermediate' Treasury bill is issued from time to time, generally to State governments which have surplus funds. Tenders are confined for the most part to a few large banks, the Imperial Bank taking something like 40 per cent. Sometimes, the Reserve Bank may have to intervene itself to ensure a successful placement. Private individuals and institutions other than banks rarely tender for bills on their own account, preferring to purchase Treasury bills through their bankers. But many of the smaller banks do not hold Treasury bills, because they are accustomed to attract deposits at relatively high rates of interest and they are therefore obliged to invest even their temporarily surplus funds in longer-dated securities which offer a higher return. In addition to Treasury bills, the Government now obtains a considerable amount of money from the banks on the basis of Treasury Deposit Receipts, which have currencies of 6, 9, and 12 months. Business done by way of rediscounting hundis has already been described, and it is sufficient to recall here that approved shroffs have limits at certain of the larger banks for the provision of this form of accommodation and that it is the endorsing shroff who provides the link between the central money market and the indigenous markets (described below). The link is, indeed, somewhat tenuous and it is here that the lack of integration which is the characteristic of non-concentrated money markets in India is most in evidence. Only the better class of hundis is taken to the banks and the relation of this rate of rediscount with those charged in the bazaar markets proper is somewhat indirect.

No account of the money market structure would be complete without a passing reference to the stockbrokers. Both in Bombay and Calcutta, these constitute one of the most important classes of borrowers. Their marginal finance is derived by way of overdraft accommodation from the banks against the security of stocks and shares under blank transfer deeds. Advances are permitted only up to a certain percentage of the value of the securities deposited and, in recent years, these requirements have had to be made much more strin-
The Indian Money Market

Both in the central money markets and in the indigenous sectors different rates of interest will apply to the several types of business, mainly because of different degrees of risk. But, in addition to this phenomenon, it is not uncommon to find that the rates in different centres diverge significantly. For our purpose, it will be sufficient to analyse the comparative position in one centre, Calcutta. In a fully integrated system, one would expect the rates in these centres to be approximately equal, since any tendency for rates to be higher in one should be offset mainly for the collection of trade accounts or the remittance of funds. Two main types of transactions are involved. First, these hundis may have been drawn by merchants for goods supplied to traders in other centres. Supporting documents, such as railway or steamer receipts, may or may not be attached. Collection of what is essentially a demand bill is effected through the agency of an indigenous banker. Normally, one day's grace is allowed and, if the hundi is not paid, penalty rates are imposed. If it is not paid by the sixth day, the matter is taken up by a Darshani Hundi Committee, which certifies the fact of non-payment and takes disciplinary action by imposing further penalties. Second, such hundis may be drawn for the purpose of remitting funds from one centre to another. Thus, an established merchant operating in several centres may draw a hundi in one centre on his office elsewhere, discount it with an indigenous banker, who sends it for collection to the centre on which it has been drawn. Trade remittances through the banking system are always subject to a charge, but this is not invariably the case with the indigenous hundi. It depends on the urgency of the need for funds. For example, in the busy season, the shroff who is arranging the remittance will himself pay a commission to the party on whose behalf the funds are being transferred. In the slack season, either funds will be remitted without payment on either side, or a commission will be paid by the party requiring the transfer.

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be related to the heavy risks which are accepted by these businessmen and (for that matter) by some of the smaller banks which provide them with the funds.

On the basis of this analysis, therefore, it is not difficult to understand the structure of interest rates which obtains in India. Where rates are high, there is not the same incentive as a more integrated system to transfer funds from centres (or sectors) where they are low. Frequently, the channels of communication are clogged or inadequate and the costs of transfer are too great. Moreover, costs must be measured in terms of convenience as well as in terms of money. For example, banks in Bombay may have funds to spare for a short period, but, in view of the costs involved and the uncertainty as to when they will need the funds themselves, they would be loath to transfer them to Calcutta to take advantage of higher rates there, so that although there is some movement of funds between the two centres, it is not nearly so general as might be supposed from first considerations alone. Moreover, it must be remembered that for similar classes of business the rates in the two centres are not greatly different and for those types of business for which high rates may be charged there are related risks, which the larger and better managed banks would be unwilling to accept.

In general, it is possible to sum up the position in India as a whole in much the same terms. For highly organised banking institutions doing substantially the same business, interest and other charges are not greatly dis-similar, differences being primarily due to costs of transfer of funds and variations in the degree of risk. By the same token, however, those markets which are not integrated with the more highly organised sections of the money market assume local characteristics, and charges are governed by particular considerations of supply and demand. The range of business done also varies more and the interest rate structure at the margin or fringe is governed by the somewhat restricted supply of finance for special purposes. This applies most obviously in the bazaar markets, but it is also apparent in the business done by some of the smaller banks. The funds available are restricted either to those from a special trading community or (as in the case of the smaller banks) to those who seek a high rate of return and are prepared to accept the consequential risks of loss. Charges to the borrower are correspondingly high. His will usually be a risky type of business, for the finance of which the larger concerns with a more conservative policy (and it should be added) less local knowledge will generally be unwilling to lend. Thus, functional specialisation does exist and many of these local and specialised markets are highly developed within their own sphere of activity. Where the development has been less complete is in the establishment of conventional relationships between markets, or groups of markets. In other words, the system is not yet fully integrated. Funds do flow both from one market to another and between similar markets in different centres, but the channels of communication are inadequate.