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New Banking Legislation

THE Government has introduced two amending bills in the present session of the Parliament relating to the banking companies, the Reserve Bank of India and the State Bank of India. The Reserve Bank is to be empowered to give accommodation to scheduled banks for export finance for 180 days (the present limit is only 90 days) and on the strength of only one endorsing signature, the State Bank will be empowered to grant medium term export credit up to .seven years (in place of the present limit of 6 months). These two measures are long overdue. The eligibility conditions in regard to export bills had hitherto been so restrictive that no such bills had been discounted with the Reserve Bank.

This paper has long been advocating the rediscounting of export bills by the Reserve Bank as a measure for saving foreign exchange; currently, unless export bills are held till maturity, either by the exporters or the discounting bank, they are rediscounted in the London Market and the country loses foreign exchange through rediscount charges. This avoidable drain on foreign exchange will now be prevented. For promoting some types of exports, it is necessary to grant medium term export credits; the measure enabling the Slate Bank to extend such credits was also therefore very necessary.

An amendment to the Banking Companies Act makes it obligatory for banks to raise the ratio of their capital and reserves to their total deposits to 6 per cent. This. too. is a welcome measure as it would strengthen the financial basis of the banking system. The earlier move on the part of the Reserve Bank to secure this through voluntary agreement was obviously misconceived, as later experience painfully brought out.

This provision for strengthening the capital base of banks is also to apply to the banking companies incorporated abroad. Currently, foreign banks operating in India have to maintain a balance with the Reserve Bank of about Rs 20 lakhs in the form of cash or approved securities in lieu of paid up capital and reserves. This balance is to be gradually raised by transferring 20 per cent of profits every year to it till such time as the Reserve Bank feels that the amount is adequate. The building up of these balances by the foreign banks will mean that either they will bring out funds or reduce their remittance of profits. In either case, apart from strengthening their own financial position in the eyes of their Indian depositors, this measure would contribute to the country's foreign exchange resources.

Another amendment relates to the cash balances to be maintained by the banks with the Reserve Bank, The present system of two different ratios — one for demand and the other for time liabilities — is to be simplified and replaced by a single ratio of 3 per cent against total liabilities, demand and time. Apart from simplifying the procedure, the amendment will also put an end to artificial inflation of time liabilities and weaken somewhat the competitive biddings on occasions by banks actively canvassing for deposits.

All the changes discussed above arc desirable and have been found necessary from experience. One cannot say the same about the change proposed for the liquidity ratio of the banks. This is not only a controversial matter but it also impinges on an area in which the Reserve Bank has neither been able to make up its mind nor formulate a sensible policy to meet the ends of planned economic development on which the country has launched. The banks had hitherto to keep 20 per cent of their aggregate liabilities in the form of cash and approved, unencumbered securities, subject to statutory requirements in regard to cash balances. This ratio is now proposed to be raised to 28 per cent, of which 3 per cent being the minimum cash balancers, 25 per cent has to be held either in cash or approved securities. The one intention behind the proposed change is to force the banks to take up more of Government loans and thus to help the borrowing programme. This is undoubtedly one of the legitimate objectives of a monetary policy but surely, this is not the only or even the overriding consideration? The higher liquidity ratio may ensure the success of the government's borrowing programme for the Third Plan, but will it also meet the credit needs of the private sector and help the latter to fulfil the tasks set to it in the Third Plan? This aspect of the question does not appear to have received the attention it deserves.

The relevant factors to be considered here are the likely deposit resources of the banks and the credit requirements for the private sector during the Third Plan period. The latter was placed by the Governor of the Reserve Bank in one of his recent speeches at Rs 600-700 crores. An estimate of the likely deposit resources of the banks during the Third Plan was attempted in the August 1961 issue of the Reserve Bank *Bulletin,* On the basis of certain assumptions, it was found that an increase in the demand deposits of the order of Rs 320 crores was indicated, Assuming a slightly higher marginal ratio of time deposits to the demand deposits— say of 120 per cent in view of the past trend — the likely growth in term deposits during the Third Plan period would be around Rs 390 crores, given total deposits of the order of Rs 700 crores.

Even taking the credit need at the lower figure mentioned by the Reserve Bank Governor, viz Rs 600 crores, would the banks be able to meet it? Banks have to maintain a higher liquidity ratio ia practice than is prescribed by statute for the smoothness of operations; with a statutory 20 per cent, they getterally maintain a ratio of 25 per cent. So even with the existing statutory provision with regard to cash and securities, the banks would have to keep 20 per cent of Rs 700 crores in cash and securities and would need at least another 5 per cent of liquid assets for operational reasons, i e, Rs 175 crores. They will then have only Rs 525 crores left for meeting the demand for credit against the minimum of Rs 600 crores mentioned by the Governor of the Reserve Bank as the likely demand. And how are they going to meet credit needs of the above magnitudes if their resources are further curtailed by higher liquidity requirements?

The above arithmetical exercise may not establish anything substantive, but it does illustrate the situation into which a change in the liquidity ratio may force the banking system. Whether it is the private or me public sector makes no difference to the success of the Plan and provision of adequate credit is implicit in the Plan itself. This is a matter into which the Reserve Bank with all its expertise may usefully look again.

States' Right to Mine Coal

THE views expressed in these columns about the compromise reached by Shri K D Malaviya, the Minister for Mines and Fuel, with Dr BC Roy over the long-standing dispute of the West Bengal Government in regard to the State Government's right of exploitation of the coal in its coal bearing lands were based upon a certain assumption in regard to the nature of control actually exercised over the distribution of coal. What this assumption was, was not left vague or even left to be inferred. That assumption was that the scheme of coal distribution in operation was a limited scheme and that in any case, it functioned very perfunctorily. This is rather a question of fact than of interpretation of statutes. Government has powers to control prices and make allocations in respect of several commodities of which coal is one. And this control can be exercised both under the Essential Commodities Act and under the Industrial Development and Regulations Act. In fact, however, there is no strict allocation of coal; what allocation there is, is indirect, through allotment of railway wagons. If coal were centrally distributed, West Bengal's sole interest in exploiting coal bearing lands acquired by It would be to contribute to the general pool and it was only to the extent it could augment the total supplies of coal that its approved projects, which would be entitled to allotment of coal by the Coal Commissioner In any case, would have a slightly improved chance of receiving adequate allotment. Its other Interest in operating its own coal mines would be to earn profits on its coal mining operations but this was certainly not what attracted Dr Roy,

The reservation of coal mining to the public sector does not rule our mining by the State Governments on their own. Reservation, therefore, exclusively to the National Coal Development Corporation could not be seriously defended, and it is not surprising that all the coal-owning States are still fighting their case in the Supreme Court and that inspite of the settlement reached with West Bengal, the case is proceeding and has not been withdrawn.

The terms of the agreement now released to the press contain nothing at all about modifying or changing central allocation of all coal raised, whether in the public sector or by the private sector. Therefore, so far as the issue of coal allocation is concerned, the agreement reached by Malaviyaji makes no change and this is what one would expect.