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THE RESERVE BANK OF INDIA ACT.

THE
RESERVE BANK OF INDIA ACT

ACT II OF 1934

WITH

NOTES AND COMMENTS

BY

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PREFACE

In this book an attempt has been made to explain and comment upon the provisions of the Reserve Bank of India Act both in their legal and economic aspects. It is hoped that it will be found useful not only by the officers and employees of the Reserve Bank and Scheduled banks and bankers in general who may be directly concerned with the business and everyday working of the Bank, but also by its shareholders who will be interested in the elections and general meetings, and members of the public including businessmen, economists and politicians who may like to have a general idea of the structure, functions and activities of the Bank as the regulator of the currency and credit system of the country.

From a legal point of view, the book has been rather a hazardous enterprise in view of the fact that I have had to explore a practically little known field of law; and this will be some excuse for the many imperfections and shortcomings of which I feel I may be guilty.

In view of the fact that some of the essential provisions of the Act are based on principles underlying similar provisions governing the Federal Reserve System of the U. S. A. the law and practice associated with the operations of that System for the past more than twenty years have been found to be a valuable guide within limits, to the interpretation of the purposes, structure and functions of the Indian Reserve Bank also. In preparing this Commentary I have accordingly made use of references to the Federal Reserve Act, the Federal Reserve Bulletins and Annual Reports of the Federal Reserve Board and the very valuable studies of Doctors E. A. Goldenweiser, Randolph Burgess and H. Parker Willis on the workings of the Federal Reserve System. I also owe a debt of gratitude

to Dr. Léon Fraser, President of the Bank for International Settlements for having made available to me some very valuable papers on Central Banking Practice not ordinarily available to other than its own member Central Banks.

In order to make the book fully useful to those whom it is intended to serve, I have added in the Appendices the texts of the Indian Coinage Act and the Imperial Bank Act as amended up to date, as well as a memorandum on Central Banking policy prepared by the Bank for International Settlements.

My thanks are due to Mr. K. Muthuswami, who is assisting me in the Bureau of Economic Research here, for the compilation of the Table of Cases, Table of Statutes and Index and for other help in connection with my task.

August, 1934,
Madura.

A. R.

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REPORT OF THE LONDON COMMITTEE

ON

INDIAN RESERVE BANK LEGISLATION

1. It was recommended by the Federal Structure Sub-Committee of the First Round Table Conference that, "with a view to ensuring confidence in the management of Indian credit and currency, . . . efforts should be made to establish on sure foundations and free from any political influence, as early as may be found possible, a Reserve Bank, which will be entrusted with the management of the currency and exchange."* The Financial Safeguards Committee of the Third Round Table Conference recommended "that steps should be taken to introduce into the Indian Legislature a Reserve Bank Bill conceived on the above lines as soon as possible."† In the Report of that Committee it was also placed on record that "The Secretary of State undertook that representative Indian opinion would be consulted in the preparation of proposals for the establishment of the Reserve Bank including those relating to the reserves." The present Committee has been set up in pursuance of that undertaking.

2. We understand that the Bill, when drafted, is to be placed before the present Indian Legislature with a view to its being brought into force before the expiry of the existing Constitution. The provisions of the Bill, therefore, will have to be designed to fit in with the existing Constitution, but in discussing them we have kept in view the conditions contemplated under the new Federal Constitution and endeavoured to frame proposals on lines which will require the minimum of adaptation to those conditions.

A complication arises from the uncertain future of Burma. We have, however, assumed that Burma, if separated, will continue to utilise the Indian currency system, and that no material changes in the Reserve Bank Act will be required.

3. We fully accept the principle that the Reserve Bank should be free from any political influence. The best device which the

*Second Report of the Federal Structure Sub-Committee, paragraph 18.

† Report of the Committee on Financial Safeguards, paragraph 4.

practical experience of other countries has evolved for achieving this object is that the capital of the Bank should be held by private shareholders, and we recommend that this plan should be adopted in the case of India.

4. In formulating a scheme for the constitution of the Board of Directors, we have borne in mind the importance of securing the representation of the economic life of India as a whole, while at the same time guarding against undue influence in the affairs of the Bank by sectional interests, acquired through the control of voting power. The proposals below are designed to fulfil these aims, but their efficacy will depend in the first place upon proper restriction of voting power. We propose that the denomination of the share should be Rs. 500. On this basis we recommend that the minimum voting qualification should be two shares, which must have been held for at least six months, and that the maximum number of votes that may be exercised by any one shareholder should be ten. If such a limitation is imposed on voting power we do not think it necessary to place any restriction on the amount of capital to be held by any one shareholder. Such a restriction would place undesirable obstacles in the way of free marketing of the shares.
[Section 4]

THE BOARD OF THE BANK.

5. We consider that the Board should be as small as practicable. The majority of the Board of Directors should in our opinion derive their mandate from the shareholders. We do not recommend that any special provision should be made for the representation on the Board of commercial bodies as such. In view, however, of the fact that in the particular circumstances of India election may fail to secure the representation of some important elements in the economic life of the country, such as agricultural interests, we recommend that a minority of the Board should be nominated by the Governor-General-in-Council under the present Constitution and by the Governor-General at his discretion under the new Constitution, it being understood that this power would be exercised to redress any such deficiencies. We agree generally that the Board should be constituted as follows:—

8 Directors representing the shareholders;

4 Directors nominated by the Governor-General-in-Council;

- 1 Governor;
- 1 Deputy-Governor (or two, if two are appointed), with no voting power;
- 1 officer of Government with no voting power.

We contemplate that the Governor would ordinarily attend all meetings of the Board, but if he is unable to do so on any particular occasion we consider that his vote should be exercised by a Deputy-Governor authorised by him to act as his substitute. [Section 8]

6. The plan which we recommend for the appointment of Directors to represent the shareholders is set forth in the next paragraph. It involves the division of India (including for this purpose Burma) into five "areas"; the election, by the shareholders resident ✓ in each area, of members of a Local Board; and the selection by the latter, from among themselves, of Directors to represent the respective areas on the Central Board.

7. In Appendix II will be found, in tabular form, our proposals for the geographical division into areas, and for the allocation among them of seats on the Central Board, and the initial allocation of share capital. It is suggested that Bombay should be the headquarters for the western area (two seats on the Central Board), Calcutta for the Eastern area (two seats), Delhi for the Northern area (two seats), Madras for the Southern area (one seat), and Rangoon for the Burma area (one seat). (The number of Local Boards for this purpose should not be capable of increase). The electoral scheme in the 1928 Bill provided for the inclusion of all the Indian States in the "Delhi Area." We consider, however, that the States should for this purpose fall into their natural geographical divisions, and our proposals, shown in detail in Appendix II, have been made on this basis. We propose that five members should be elected to each Local Board by the shareholders "resident" in the area according to the definition given in clause 4 (4) of the 1928 Bill. The members so elected should appoint, from among themselves, the Director or Directors to represent the area on the Central Board. Provision should be made to enable a substitute Director to be appointed from and by a Local Board in case a Director representing it is unable to attend a particular meeting. [Schedule I and Sections 9 & 12 (2)]

8. Clause 6 of the 1928 Bill provides for the opening of offices at the headquarters of the five areas which we propose. We observe that this clause as it stands would oblige the Bank to establish a branch in London. We understand that it is the recognised practice of Central Banks to conduct their operations in another country through the agency of the Central Bank of that country. We do not consider that the Board should be precluded by statute from following this practice. We therefore recommend that the words "and London" should be omitted from clause 6, the effect of which will be to make the establishment of a London branch optional. Should the Bank arrange to employ the Bank of England as its agent in London, we contemplate that the arrangement would be reciprocal and that the Bank of England would employ the Reserve Bank as its agent in India. [Section 6]

9. Apart from their functions in the machinery by which Directors are appointed, the Local Boards would have no executive duties, except as may be delegated to them by the Central Board. Otherwise they would be purely advisory bodies. In particular, they might play a valuable part in the security of commercial paper, analogous to the functions of the discount committees established in Belgium, Bulgaria, Japan and Lithuania. With a view to ensuring that all appropriate interests, agriculture and the Indian States in particular, are adequately represented, the Central Board should be empowered to nominate to each Local Board not more than three additional members who should be full members of the Local Board, except that they should not be eligible to be returned as representatives of the area on the Central Board, nor to take part in the selection of such representatives. [Section 9]

10. As regards the qualification of elected Directors, we consider a provision on the lines of sub-clause 2 of clause 11 of the Bill of 1928 to be desirable. We would also provide that within six months of their appointment to the Central Board the four nominated Directors must become possessed of the same share qualification as is prescribed for Directors elected by the shareholders. We do not, of course, suggest that a share qualification must be acquired by the Governor, the Deputy-Governor or Governors, or the Government officer. We accept the disqualifications set out in clause 8 of the 1928 Bill, to which, however, we could add "Insolvency." We have considered whether the disqualification of Government

REPORT OF THE LONDON COMMITTEE

officials should apply also to officials of Indian States. We are all agreed that, so far as elected members of Central or Local Boards are concerned, this disqualification should apply, but as regards nominated directors, either on the Central or Local Boards, the Indian States representatives have pressed that an exception should be made. Recognising that there might on occasions be practical difficulties in finding suitable non-official representatives of the Indian States, a majority of the Committee are prepared to recommend an exception in this case, provided that it shall not apply to officials of the Government of India lent to an Indian State. [Sections 10 and 11]

11. The qualifications and disqualifications applicable to members of a Local Board, whether elected or nominated, should, subject to what is said in paragraph 10 above, be the same as those applicable to the elected members of the Central Board. [Sections 10 and 11]

12. We recommend, in order that the Reserve Bank may be able to commence operations, that the first appointment of Directors should be made by the Governor-General-in-Council, suitable arrangements being made for retirement in rotation. [Section 15]

13. The method of appointing the Governor is a matter of the highest importance. It is essential that this officer should command general confidence, both in India and abroad. As regards the appointment of the Governor and Deputy-Governor (or Deputy-Governors), the majority of the Committee hold that the Governor-General in his discretion should be the appointing authority when the new Constitution comes into force. Those who were of this opinion felt no doubt that before making these appointments the Governor-General would ascertain the views of the Board of the Bank. A minority of the Committee, however, hold that these appointments should be made by the Board of Directors, subject to the approval of the Governor-General. An attempt to harmonise views was made by proposing that the existing provision of the Imperial Bank constitution should be followed in drafting the Bill, and that the Governor and Deputy-Governors should be appointed by the Governor-General after consideration of the recommendations of the Board of the Bank. This solution, as a compromise, was acceptable to all members of the Committee except four. [Section 8 (1) (a)]

SHARE CAPITAL AND SHARE REGISTERS.

✓ 14. We recommend that the original share capital of the Bank should be Rs. 5 crores, divided into shares of Rs. 500 each, which should be fully paid: that the initial allocation as between the five areas should be on the lines indicated in Appendix II; that a separate share register should be maintained in each of the five areas; and that shares should be transferable from one register to another, so that there would be a free market in them, but shareholders should only be entitled to vote in respect of the areas in which they are resident. [Section 4]

STRUCTURE OF THE BANK.

✓ 15. The two previous Bills provided for separate Issue and Banking Departments as in the case of the Bank of England, and we understand that this provision has met with general approval in India. We recommend that the new Bill should be drafted on this basis.

BUSINESS OF THE BANK.

✓ 16. We approve generally of the provisions of clauses 17 and 18 of the Bill of 1928, but we consider that some extension may be required to enable the Indian States to participate in the Reserve Bank Scheme, and detailed suggestions of this nature are included in Appendix I.

✓ 17. The Banking Enquiry Committee recommended* that additional provision should be made enabling the Bank to make loans and advances on the security of moveable goods, wares and merchandise, as well as against the warehouse warrants and warehouse receipts representing such goods. We do not feel able to recommend any such provision, since it would tend to render the Bank's resources less liquid, and might involve it in undesirable competition with commercial banks. [Section 17]

✓ 18. An important question arises in regard to clause 18. Since the Hilton Young Commission reported and the previous Bills were drafted, Central Banking practice in other countries has developed in the direction of utilising open market operations to an increasing

*Report of the Indian Central Bank Enquiry Committee of 1931, paragraph 407.

extent for the purpose of regulating credit. Clause 18 as it stands might be read as necessitating a meeting of the Board on each occasion on which such operations are required. Since action may be necessitated, for the purpose of regulating credit, with a degree of urgency which does not permit prior consultation with the Board, it should be made clear that the Board is not precluded from delegating to the Governor powers in this behalf for the above-mentioned purpose. [Section 18]

EXCHANGE OBLIGATIONS OF THE BANK.

19. The questions which arise in connection with the exchange obligations to be imposed on the Bank present special difficulty in existing circumstances. In the prevalent state of monetary disorganisation throughout the world, it is impossible to incorporate in the Bill provisions which would necessarily be suitable when monetary systems generally have been re-cast and stabilised. In these circumstances we consider that the only sound course for India is to remain on the sterling standard. On this basis the exchange obligations incorporated in the Bill must necessarily be in accord with the rupee-sterling ratio existing at the time when the Bill is introduced. This statement does not, however, imply any expression of opinion on the part of the Committee on the merits or demerits of the present ratio. The ratio provisions in the Bill are designed to make it clear that there will not be any change in the *de facto* situation by the mere coming into operation of the Reserve Bank Act.

A considerable majority of the Indian Delegates feel it their duty to record their view that a suitable exchange ratio is one of the essential factors for the successful working of the Reserve Bank. They point out that considerable changes have occurred in the currency bases and policies of almost all the countries of the world in the last few years. In their view it is for the Government of India and the Legislature to examine these and all other relevant considerations with a view to ensuring that the minimum possible strain is placed on the currency system of India.

We are all agreed that it should, in any case, be made clear in the Preamble that the whole question of the monetary standard best suited to India will have to be reviewed when the international monetary position has clarified itself and become sufficiently stable to make it possible to frame more permanent provisions.

20. It will be necessary in the Bill to provide limits to the ✓ range of exchange fluctuations by prescribing upper and lower points at which the Bank will be required to buy and sell on demand sterling for immediate delivery. According to the practice now prevailing upper and lower points have in fact been retained as though the rupee was still on a gold basis. As the fixing of new points would in any case have to be on an arbitrary basis we recommend that this practice, to which the public have become accustomed, should be continued. [Sections 40 & 41]

ASSETS AND LIABILITIES OF THE ISSUE DEPARTMENT.

21. The addition of 40 crores to the liabilities of the Issue Department for the purpose of providing for rupee redemption requires reconsideration in view of the large return of rupees from circulation since the Hilton Young Commission reported and the indications as to the probable trend of the movement of rupees in and out of circulation in the future. We recommend that, as the future return of rupees over a series of years is likely to be ✓ considerably less than in the past few years, the rupee redemption fund ✓ should be dispensed with and in its place the following scheme should be adopted:—

(1) The amount of rupees transferred at the outset to the Bank should not exceed Rs. 50 crores.

(2) Any surplus of rupees which this arrangement would enable Government to remove from the reserve should be held by Government in a separate account, the silver being held as bullion, not as coin. Subject to further consideration, such rupees should not be used, except for the purpose specified in (3) below.

(3) In any year in which the minimum holding of silver rupees by the Bank exceeding 50 crores of rupees or one-tenth of the total amount of the reserve, the Bank would have the right to make over the surplus to Government to an amount not exceeding 5 crores of rupees in any year, and Government would be required to pay full value for these (to the extent of 40 per cent. in sterling or other external assets acceptable to the Bank if the Bank so required, and if the Bank's external assets at the time did not exceed 50 per cent. of its total reserve).

(4) If in any year the Bank's maximum holding fell below the amounts indicated above, Government would similarly have the right to sell rupees to the Bank up to a maximum of 5 crores in any one year.

We observe in this connection that the omission of any provision for a specific rupee redemption fund makes it all the more necessary that the reserves of the Bank should at the outset provide an ample margin over the statutory amount. Under the proviso to clause 33 of 1928 Bill, the initial proportion of gold and sterling assets must be not less than one-half of the liabilities of the Issue Department. We do not propose any alteration in this figure in the new Bill, but we think that this proportion may not necessarily be adequate, and we recommend that the question whether a higher proportion is required at the outset should, before the Bank is set up, be carefully considered by Government in the light of all the prevailing circumstances.

22. As regards the holding of Government of India rupee securities, the question was raised whether the limits proposed in the second proviso of clause 31 (3) might not prove unduly restrictive of the Bank's open market operations; and we recommend that this point should be further considered in India.

23. With regard to the remainder of the reserve, we recommend that "Gold Securities" should be replaced by "Sterling Securities." The holding of gold securities would be not merely inappropriate to a sterling standard, but, in the present state of uncertainty, a possible source of weakness. As regards the aggregate proportion of gold coin or bullion and sterling securities to be held, we recommend that the minimum figure of 40 per cent. proposed by the Hilton Young Commission and adopted in the previous Bills should be retained.

24. As regards the distribution of this minimum between sterling and gold various considerations have to be taken into account. On the one hand it must be recognised that the Bank will always require to hold a substantial amount of sterling in order to enable it to fulfil its sterling obligations. Indeed it might be argued that so long as the rupee is not based on a gold standard there is no logical necessity to prescribe a minimum holding of gold and that

any such limitation would restrict the freedom of the Bank's operations and would, to that extent, be a source of weakness in relation to its obligations to maintain the currency standard. There is, moreover, a further argument that as gold carries no interest any undue proportion of gold holdings would unjustifiably reduce the Bank's profits and so impose, indirectly, an unnecessary burden on the Indian taxpayer. As against these considerations, must be weighed the deep and widespread feeling in India in favour of holding gold as affording ultimately the most reliable form of reserve, a feeling which may necessitate some provision for a minimum gold holding in order to secure the confidence of the Indian public in the stability of the Bank. While individual members of our Committee have been inclined to attach varying degrees of importance to these different considerations we have been able to reach agreement on a recommendation that the Bill should prescribe a minimum gold holding of Rs. 35 crores.

The minimum of Rs. 35 crores represents actually about 20 per cent. of the present note liability. Should, however, through any considerable expansion of the note issue, this percentage fall below 15 per cent., some members of the Committee are of opinion that the position should be immediately reviewed.

25. The question of valuation of the gold assets presents some difficulty. At a time when monetary standards are completely disorganised, there is, in fact, no logical figure applicable to the valuation of gold reserves. We consider that the best course would be to retain the valuation laid down in sub-clause (4) of clause 31. This would be in accordance with the practice at present followed by the Bank of England and in India, where gold continues to be valued at the old parity. Under this arrangement the existing holdings would be covered against loss by a wide margin. The possibility would obviously be present that the Bank might gain a large premium on the gold handed over to it by Government. The question as to how such premium should be dealt with, especially in the event of sales being made in the intermediate period pending revaluation of the gold, raises, complex practical issues which we have not fully discussed. In principle such profits should belong rather to the Government than to the Bank, but our view is that this unrealised margin should in some way or other be kept available for strengthening the position of the currency reserves. We recommend

that detailed proposals should be worked out by the Government of India for consideration during the passage of legislation on this subject. [Sections 33 & 34]

26. We approve generally of the provisions of clause 41 of the 1928 Bill, relating to the suspension of reserve requirements and the connected tax provision. We think it would be well to bring clause 41 into a closer connection with clause 31 in order to make it clear that the "minimum" reserve can, and should be utilised whenever this is called for the circumstances. [Section 37]

RESERVE FUND AND ALLOCATION OF SURPLUS.

27. We approve, generally, the provisions for "Reserve Fund and Allocation of Surplus" in clause 46 of the 1928 Bill, subject to the following modifications in regard to the distribution of dividends. The appropriate rate for the fixed dividend must depend to some extent on the return on comparable securities at the time of issue of the shares. We recommend that the Bill should empower the Governor-General-in-Council to fix this rate, subject to a maximum of 5 per cent. Provision should also be made, on the lines of the Third Schedule to the 1928 Bill, for a gradually increasing dividend up to a maximum of 6 per cent. In determining the fixed rate of dividend the Governor-General-in-Council should take into account, not only the yield on Government long-term securities, but also the desirability of attracting the small investor in the mofussil and thereby securing a wide distribution of the shares [Sections 46 & 47]

SCHEDULED BANKS.

28. We approve the principle of clause 44 of the 1928 Bill, under which Scheduled Banks are required to maintain minimum balances with the Reserve Bank. Some doubts have been expressed as to the appropriateness of (a) the criterion for inclusion in the schedule, viz., Rs. 3 lakhs paid-up capital and reserves; and (b) the percentages prescribed in sub-clause (1) of that clause. We recommend that these two questions should be reconsidered in India together with the question whether the criterion should be based on the amount of deposits rather than on the paid-up capital and reserves. [Section 42]

RELATIONS OF THE RESERVE BANK WITH THE IMPERIAL BANK OF INDIA.

29. We recommend that the Reserve Bank should be required to enter into an agreement with the Imperial Bank on the general lines of clause 45 of the 1928 Bill, but we consider that the period of 25 years prescribed in that clause is too long, and we suggest that this point should be further considered by the Government of India. The initial period, however, should be of substantial duration, with provision thereafter for termination on several years' notice given by either side. The agreement should further contain a stipulation that its continuance is dependent on the maintenance of a sound financial position by the Imperial Bank.

30. With regard to the Second Schedule to the 1928 Bill, we approve of the provision that the Imperial Bank should be the sole agent of the Reserve Bank at all places in British India where there is a branch of the Imperial Bank of India and no branch of the Banking Department of the Reserve Bank. It should be understood that this only applies to branches that are in existence at the time when the Act comes into force. We also agree that the Imperial Bank shall not, without the approval of the Reserve Bank, open any branch in substitution for a branch existing at the time when the agreement comes into force. As regards other branches that may be opened in the future, the Reserve Bank should be under no obligation to employ the Imperial Bank and should be free to make its own arrangements. The agency terms provided for in paragraphs 2 and 3 of Schedule II will require reconsideration in the light of present circumstances, and we recommend that the Government of India should frame revised terms in consultation with the Imperial Bank.

31. It was submitted to us that, apart from the question of remuneration for services to be rendered, the Imperial Bank of India has a moral claim for compensation in respect of its disappointed expectations and of commitments which it undertook, by arrangement with Government, before the institution of the Reserve Bank was contemplated. It was suggested to us that such compensation should be given in the form of an allotment of a part of the share capital of the Reserve Bank to shareholders of the Imperial Bank. We do not consider that the question whether the Imperial Bank is

entitled to compensation is within the purview of this Committee, but, in any case, we cannot recommend any special allocation of Reserve Bank shares to the shareholders of the Imperial Bank, as this would be inconsistent with our scheme for the distribution of shares on the broadest possible basis throughout India. We have no doubt, however, that any claim for compensation which may be put forward by the Imperial Bank will receive due consideration by the authorities in India. If the claim is conceded we consider that the compensation should be given in some other form. [Section 45 & Schedule III]

GENERAL.

32. The Committee considered whether the powers to be given to the Governor-General-in-Council in various clauses of the Bill should, under the new Federal Constitution, be exercised by the Governor-General at his discretion or by the Governor-General on the advice of his Ministers. In agreeing to the recommendations recorded below, some of the members took into account the powers which they assume the Governor-General will possess under the new Constitution Act to intervene if on any occasion his special responsibilities are involved.

In clause 41 of the 1928 Bill (Suspension of Reserves) no agreement was reached between the three alternatives of the exercise of these powers—

- (a) by the Governor-General at his discretion;
- (b) by the Federal Government; or
- (c) by the Federal Government with the approval of the Governor-General at his discretion.

In clause 43 and 52 of the 1928 Bill (Forfeiture of Right of Note Issue and Liquidation) it was agreed that the powers should be exercised by the Federal Government with the approval of the Governor at his discretion.

In clause 53 (Regulations) it was agreed that the power should be exercised by the Federal Government.

33. In the preceding paragraphs we have dealt with all the major questions in respect of which we recommend any departure

from the provisions of the 1928 Bill. In other respects we recommend that the principles of that Bill should be followed in drafting the new Reserve Bank Bill. There are, however, a number of minor points on which we recommend modification of the provisions of the 1928 Bill, either as being consequential on our major recommendations or desirable on other grounds. These suggestions are set forth in Appendix I, and for convenience of reference we annex to our Report a copy of the 1928 Bill.*

APPENDIX I.

(See paragraph 33 of Report.)

Title and Preamble.—The reference to “Gold Standard Currency” will require amendment.

Clause 1 (1).—This clause will need to be similarly amended.

Clause 1 (2).—We have assumed that Burma, if separated, will continue to utilise the Indian currency system. If the decision ultimately reached is otherwise, an amendment of this sub-clause will be necessary.

Clause 1 (3).—A modification of dates will be necessary.

Clause 1 (4).—We recommend that this sub-clause should provide that Chapter III shall be in force for a period of 25 years, and shall continue in force thereafter until revoked or modified by further legislation.

Clause 2 (g).—The definition of a “gold standard country” will have to be replaced by that of a “sterling standard country.”

Clause 4 (8).—The scheme of allotment should be modified so as to provide for preferential allotment to the extent of two shares (the suggested minimum qualification for a vote) being given to applicants for two shares and over. A specific provision should also be made excluding Government from voting power in respect of any capital left in its hand.

Clause 8 (1) (a) (i).—We would amend this to read:—

“engaged in the direction of agricultural, commercial, financial or industrial activities, or”

* Not printed here.

Clause 11 (1).—Elected Directors should be removable by the Governor-General-in-Council on a resolution passed by the Board by a majority consisting of not less than nine Directors. Other members of the Board be removable by the authority which nominated or appointed them.

Clause 13.—Election rules should be drawn up by the Bank in the manner provided for in clause 53.

Clause 15 (1).—Provision will be necessary for calling local meetings to elect the Local Boards.

Clause 15 (2).—Bearing in mind the widespread practice of blank transfers in India we consider that members of Local Boards might be empowered to call upon any registered and resident shareholder to make a statutory declaration to the effect that he is actual owner of the shares registered in his name.

Clause 17 (1).—Provision should be made to enable the Bank to act as Bankers for Indian States.

Clause 17 (2) (c).—We would add after the words "Local Government" the words "or such securities of an Indian State as may be specified in that behalf by the Governor-General-in-Council on the recommendation of the Central Board of the Reserve Bank."

Clause 17 (3).—The reference to "Gold standard countries" shall be changed to "Sterling standard countries."

Clause 17 (7) and (8).—It has been suggested that in present conditions these sub-sections are unduly restrictive as regards the maturities of Government securities in which the Bank is permitted to deal. We recommend that this point should be further examined by the Government of India. An amendment similar to that already suggested above to sub-clause 17 (2) (c) might also be made to sub-clause 8.

Clause 17 (11).—The words "or Indian State" might be added after the words "Local Government" to admit of the Bank acting as agent for the Indian States.

Clause 17 (14).—We consider that external borrowing should be expressly confined to other Central Banks, and that in that event no limitation need be placed on the amount which it is permissible to borrow externally.

Clause 17 (16).—We would redraft this sub-clause as follows:—

“Generally, the doing of all such matters and things as may be incidental to, or consequential upon, the provisions of this Act and not prohibited by this Act.”

Clause 18.—We would substitute for the words “in the interests of Indian trade or commerce, or for the purpose of enabling the Bank to perform any of its functions under this Act,” the words “for the purpose of regulating credit in the interests of Indian trade, commerce, industry and agriculture.”

A further amendment of this clause has been recommended in paragraph 18 of our Report.

Clause 31.—Here, and in other clauses where it is referred to, the provision for “gold securities” should be replaced by “sterling securities.”

Clause 31 (3).—It is for consideration whether it should not be made clear that the “Government of India rupee securities” must be marketable securities.

Clause 31 (6).—This sub-clause will require amendment in view of the adoption of a sterling standard.

Clauses 32—37 will require modification in the light of our proposal for the omission of provision for a specific rupee redemption fund.

Clauses 38—40.—These clauses will require to be replaced by provisions on the lines indicated in paragraphs 19 and 20 of our Report.

Clause 53.—Amendments and additions will be required in consequence of certain of our recommendations.

REPORT OF JOINT COMMITTEE

ON THE

RESERVE BANK BILL

Notes on clauses.

[*Clauses 1 to 42 correspond to sections 1 to 42 of the Act, and corresponding sections to the remaining clauses are indicated within square brackets at the beginning of each clause.*]

Preamble.—We have made a verbal alteration to indicate more definitely what we consider to be the main purposes of the Bill.

Clause 1.—Although we agree that no specific date can be inserted for setting up the Bank, we desire to represent strongly to the Government that the Bank should be set up with all possible speed.

We have substituted the words "This Act" for "Chapter III" in sub-clause (4) because we do not see any reason why the other Chapters of the Bill should be treated differently from Chapter III.

Clause 2, sub-clause (b).—We considered whether it was necessary to frame a more comprehensive definition of "bank note" but decided that this was unnecessary and that the definition might be omitted.

Sub-clause (d).—We are of opinion that investments of external assets should be confined to Government securities of the United Kingdom and that purchases of foreign currency should be restricted to sterling. We have modified clauses 17 and 33 accordingly. The definition of sterling standard countries therefore becomes unnecessary.

Sub-clause (e).—We have altered the definition of "provincial co-operative bank" because the wording of the original Bill would not have covered the special conditions as regards co-operative bank in the United Provinces.

Clause 4, sub-clause (1).—In order to ensure that the shares of the Reserve Bank shall be widely held we recommend that the nominal value of each share should be reduced from Rs. 500 to Rs. 100.

Sub-clause (2).—It was represented to us that shares should not be allowed to be transferred from one register to another because this might lead to certain registers being denuded of a large number of shares, thus leaving the holders of a comparatively small number of shares to elect representatives to the Local Board and thereby to the Central Board. We have come to the conclusion that the advantages of free marketability are so great that transfers from one register to another should be freely allowed. We further consider that a contingency such as that referred to is extremely unlikely to arise and that a majority of the shares of the Reserve Bank when once allotted will be firmly held as a lock up investment by the original holders. If, contrary to our expectations, it is found that one register is accumulating a large number of shares while another is being denuded by a really substantial percentage, the Government should consider the question of bringing forward suitable amending legislation in order to rectify the position.

Sub-clause (3).—As regards the provisions of this sub-clause, while we are prepared to accord full equality of treatment to United Kingdom British subjects so long as they are normally resident in India on the ground that the United Kingdom Government gives the same reciprocal treatment to Indians resident there, the case is different as regards those Dominions which in various ways apply discriminatory provisions to the Indian Subjects of His Majesty. We feel that every occasion should be taken to assert the principle that the citizens of such Dominions should not be allowed equal privileges in India so long as their Governments maintain any measure of discrimination against Indians, and we have taken the opportunity of this particular Bill to give effect to this principle by recommending changes in sub-clauses (3) (b) and (3) (c).

Sub-clause (3) (c).—As regards this sub-clause, it has also been brought to our notice that the limitations on share-holding provided for in sub-clauses (3) (a) and (3) (b) might be defeated if subjects of a foreign country or of a British Dominion which has discriminated against India were to form themselves into a limited company for the purpose of holding shares in the Reserve Bank, and we therefore considered whether some provisions should be inserted to the effect that a company registered under the Indian Companies Act, 1913, should only be allowed to hold shares if a majority of the shareholders consisted of persons qualified under sub-clauses (3)

(a) and (3) (b). It appeared to us on further examination, however, that any such provision would be extremely difficult to enforce in practice owing to the constant variations which would be possible in the shareholders of any company. On the other hand, the alternative of excluding companies not registered in India altogether would go too far, for there are many private and public companies formed for the purposes of investment which might hold shares in the Reserve Bank. We have not therefore proposed the introduction of any restriction, but we recommend that the Government and the Central Board of the Reserve Bank should watch carefully for any signs of evasion of the purposes of sub-clauses (3) (a) and (3) (b) by the formation of companies by persons disqualified from holding shares. If any such abuse were to attain serious dimensions we think that the Government should consider amending legislation.

Sub-clause (4).—We have recommended the deletion of the discretionary power proposed to be vested in the Central Board to decline without giving any reasons to allot shares to any applicant or to register any transfer of shares.

Sub-clauses (5) and (6).—We consider that if the scheme for the election of Directors to the Boards of the Reserve Bank is to work satisfactorily the proviso to sub-clause (5) should be deleted and that sub-clause (6) should be amended in the manner suggested by us so as to restrict the sale by the Governor-General-in-Council of unallotted shares only to residents of the areas concerned, except as regards a part of the unallotted shares from the Delhi area which we have treated as a special case.

We have carefully considered the manner of allotment of shares in order to secure as wide a distribution of voting rights as possible and to provide fair facilities for investment by the less wealthy classes. In view of the reduction which we have recommended in the nominal value of each share we propose that five shares should carry one vote. In allotting the shares assigned to a register the Central Board should therefore in the first instance allot five shares to each qualified applicant who has applied for five or more shares. Of the remaining unallotted shares, shares up to the amount of one-half of the balance should be allotted to applicants for less than five shares. The balance still remaining should be allotted to appli-

cants for more than five shares, the distribution being so made as to secure the widest distribution of voting rights.

In order to avoid any possibility of difficulty for the Directors elected to the Boards of the Reserve Bank to acquire the prescribed number of qualifying shares, we recommend that a sufficient number of shares should be reserved by Government to be available for purchase by the Directors and members of Local Boards at par, and that these purchasers should give an option to Government to repurchase such shares at par when they retire.

We attach great importance to securing that as large a proportion of the population of India as possible shall become shareholders of the Reserve Bank and thereby take an interest in its efficient working. We therefore recommend that the widest publicity should be given to the prospectus of the issue of the Reserve Bank shares and that facilities for applications to investors should be given through Government post offices and treasuries.

Sub-clause (5).—We have come to the conclusion that a more equitable distribution of the original capital having regard to the population of the areas concerned be made in the following manner:—

Bombay register—140 lakhs;

Calcutta register—145 lakhs;

Delhi register—115 lakhs;

Madras register—70 lakhs;

Rangoon register—30 lakhs;

We have suitably amended this sub-clause.

Sub-clause (6).—We have split up this sub-clause into a number of sub-clauses. The original arrangement seemed unwieldy.

Clause 5.—It was originally provided in the Bill that any additional shares created should be assigned to the various registers in any manner fixed by the Central Board with the previous sanction of the Governor-General-in-Council and that the latter should also determine the manner in which such additional capital should be

allotted to the various areas. We have recommended that the distribution should be in the same proportions as fixed for the original share capital.

In view of the liability that would be placed on the Government by any increase in the share capital of the Bank we consider that the previous approval of the Central Legislature should be obtained to any increase in the share capital.

We have also made certain minor consequential amendments in this clause.

Clause 6.—It was suggested to us that branches of the Reserve Bank should be opened at Lahore, Cawnpore and Karachi. The principal reason for this suggestion was that the banks and the public at those places would not otherwise get the same facilities as would be available at places where there were offices and branches of the Reserve Bank. We wish to emphasize that at places, where it has no branch the Reserve Bank must through its agencies, provide facilities of the same adequacy as are available at places where it has offices or branches. We do not desire to fetter the discretion of the Reserve Bank in regard to the opening of branches as it should be guided in this matter by practical experience. We, however, recommend that in the Agreement between the Reserve Bank and the Imperial Bank of India it should be made clear that the former is not prevented by that Agreement from opening a branch anywhere if it considers this necessary or desirable.

We considered in this connection whether it would be proper to place a statutory obligation on the Reserve Bank to open a branch in London. We have noted that the present tendency among the Central Banks of the world is not to establish branches outside their own countries but to employ other Central Banks as their agents at foreign centres. While we should be unwilling to make any recommendation which could be construed as a failure to appreciate the importance of international co-operation between the Central Banks of various countries, we cannot accept the view that the practice of other countries affords an exact parallel to the particular case of India as regards representation in London. We therefore think that the Board should have absolute discretion to open a branch in London and we recommend that the provision requiring the prior assent of the Governor-General-in-Council should be deleted.

We recommend that, as in the case of the Imperial Bank, the Head Office of the Bank should be migratory, as we consider that otherwise there might be some risk of failure to secure evenly balanced consideration of the varying interests of different parts of the Indian continent. We have therefore amended the clause to provide that there shall be offices in Bombay, Calcutta, Delhi, Madras and Rangoon and have left it to the discretion of the Central Board how they should move their headquarters between them.

Clause 7.—We have made a small drafting amendment to bring out more clearly the intention of this clause.

Clause 8, sub-clause (1) (a).—We consider that one of the most vital points affecting the successful operation of the Bank will be the personality and qualifications of the Governor. It is in our view essential that he should be a man who will command the confidence of the public generally and particularly of banking and commercial circles, so that the policy of the Bank which will largely depend on his guidance, may be accepted as authoritative. We do not consider that these conditions will be fulfilled unless he is a man who has established a position in the business world and we have therefore recommended the insertion of a provision in a new sub-clause (2), to cover appointments, made both under clause 8 and clause 15, that he must be a man "of tested banking experience covering a period of at least five years." We have given full consideration to the arguments put forward by the Government members who, while not differing from our general appreciation of the position as stated above, have warned us that the actual definition of the qualifications which we have recommended may, on the one hand, prove ineffective for excluding unsuitable appointments, and, on the other hand, prove unduly hampering to the discretion of the appointing authorities and by their very rigidity exclude a man who might be exactly fitted for the post. They have pointed out to us that the commercial banking experience is not necessarily an adequate qualification for the head of a Central Bank, and that recent experience of other countries affords many examples of extremely successful appointments of men who would have been excluded by the words of our proviso. While recognizing the force of these arguments, we think it necessary definitely to provide in the statute for the exclusion of certain types of appointment which we should consider undesirable, and we are prepared to face the necessity for amending

legislation in the event of our words proving in practice to be unduly hampering.

We do not think it necessary to impose any similar restriction on the selection of the Deputy Governor because these appointments will afford a suitable opportunity for giving practical banking experience to men who are otherwise well qualified.

We consider that the responsibilities falling on the chief executive officers of the Bank will be such that it will from the very outset be necessary that there should be two Deputy-Governors and we have amended this clause so as to make their appointment obligatory. Many of us wished to add a provision that of the three highest posts thus created (*viz.*, the Governor and two Deputy-Governors) one at least should be an Indian. We have, however been informed that the official members in charge of the Bill are prepared to give a definite assurance in the Legislature that the Government will take account of our representations and that it will be its policy in making the first appointments and thereafter that at least one of the three shall be a qualified Indian. We are satisfied with this assurance.

We wish to make it clear that we accept the proposals of this clause as regards the appointment of the Governor and Deputy Governors on the understanding that there must be prior consultation between the Governor-General-in-Council and the Central Board before any recommendation is made—in short that the practice hitherto followed in the case of the appointment of the Managing Governors of the Imperial Bank, to which an exactly similar statutory provision has applied, should be observed.

Sub-clause (1) (b).—We considered whether any addition should be made to this sub-clause in the form of a direction to the Governor-General-in-Council as to the manner in which he should exercise his power of nomination. We have been assured that it is intended that this power shall be used to ensure that territorial or economic interests which have not secured adequate representation in the elections shall have such inadequacy corrected by this means. We do not consider it appropriate to embody in the statute any specific provision for the fulfilment of this intention, but we consider that in the instrument of instructions to the Governor-Generals

a passage should be inserted making it clear that this power should be exercised in the general manner indicated above and in particular to secure adequate representation of the interests of agriculture and co-operative banking if these interests had not secured such representation among the elected directors.

Sub-clause (2).—We have made an alteration in the wording here. In view of the Government's interest in the financial earnings of the Bank we consider that it should have a voice in fixing the salaries paid to the chief executive officers.

Sub-clause (4).—We recommend that nominated Directors should hold office for five years in the same way as elected Directors. We consider that the provision in its original form might tend to fetter their independence of judgment. We have proposed an amendment for the same purpose in clause 11.

Clause 9, sub-clause (1) (b).—We have filled in an obvious lacuna in this sub-clause and in the new proviso which we have added, we have indicated clearly for the guidance of the Central Board, the object with which the power of nominating three members to each local board has been conferred on that body.

Sub-clause (2).—We have reduced the value of a voting qualification from two shares of Rs. 500 each to five shares of Rs. 100 each.

We have included a provision for the exercise of shareholders' votes by proxy which is undoubtedly necessary. We have, however, thought it desirable to include certain limitations as to the persons who may hold proxies for this purpose, and also to introduce words which will make it clear that a shareholder should not be allowed to give a general proxy, and that proxies should not be accepted if made out under a general power-of-attorney.

Sub-clause (4) and (4-A).—We consider it essential for the convenience of the shareholders that the Bank should give adequate notice of elections to the local boards and publish a list of shareholders which should be available on purchase. For the latter purpose the Bank must have power to suspend the registration of transfers for a reasonable period preceding the election. We have made amendments to give effect to these purposes.

The other amendments suggested by us in this clause are of a drafting nature only.

Clause 10, sub-clause (1).—We have omitted certain words in sub-clause (1) (a) and deleted sub-clause (1) (b) which appeared to us to be unnecessary as the qualifications are sufficiently defined by sub-clause (1) (a).

Sub-clause (2).—We have added in this sub-clause certain additional disqualifications taken from the Indian Companies Act which seem to us to be necessary.

We have omitted the proviso to this sub-clause as we considered that the objections to a State official being appointed would be no less than to any other Government official.

Sub-clause (2-A).—We have proposed the insertion of a new sub-clause on the lines of a similar provision in the Imperial Bank of India Act.

We have also suggested in this clause certain minor amendments of a drafting nature.

Clause 11, sub-clause (1).—For the purpose explained in our note on clause 8 (4) we have amended the proviso to this clause so as to place nominated directors on the same footing as elected directors.

Sub-clause (2).—We have reduced the value of qualifying shares from Rs. 10,000 to Rs. 5,000. We consider the similar figure adequate.

We have added a provision at the end of this sub-clause for the vacation of office in the case of continued absence. It is of the highest importance that Directors and Members of Local Boards of the Reserve Bank should be ready to give adequate attention to their responsibilities.

Sub-clause (3).—We have altered the wording of this sub-clause so as to make the provision mandatory instead of discretionary. We have also deleted as unnecessary certain words in this sub-clause regulating the period within which directors should be required to acquire the prescribed number of qualifying shares as the

addition which we have suggested in new clause 4 (8) should obviate any difficulty.

Sub-clause (3-A).—We have inserted a new sub-clause (3-A); we feel that in the interests of the Bank a provision on these lines is desirable.

Sub-clause (4).—We have increased the period within which a member of the Legislature must demit office. To limit this to one month would, in our opinion, present practical difficulties.

Clause 12, sub-clause (1).—We think that the initiative in this matter should come from the Central Board. We have amended this sub-clause accordingly.

Sub-clauses (3) and (4).—We have rearranged the provisions of these sub-clauses as it did not appear to us that in their original form they provided properly for maintaining at all times the representative nature of the elected members of the Central Board. The effect of our proposals is that a vacancy of an elected member in the Central Board will be filled in the following manner: first an election to fill his vacancy in his Local Board and then an election by the newly completed local board to fill the vacancy in the Central Board. In the case of a vacancy of an elected member of a Local Board who is not also a member of the Central Board we consider that it would suffice for such a vacancy to be filled by co-option until such time as the Local Board is called upon to fulfil its function of electing a member to the Central Board. Before that is done, the co-opted member should be replaced by an elected member.

Clause 13, sub-clause (1).—We have made an amendment consequential to our amendment of clause 6.

Sub-clause (1-A).—We think that provision should be made so as to enable any three Directors to convene a meeting of the Central Board. We have added this new sub-clause accordingly.

We considered whether it was necessary to provide what should be a quorum for a Directors' meeting, but have agreed that this matter should properly be governed by regulations to be made under clause 52.

Clause 14.—We have made a consequential amendment corresponding to our amendment of clause 6. We have followed the procedure of the Imperial Bank of India.

Clause 15, sub-clause (3) and (4).—We have redrafted these sub-clauses on lines which we consider to be a distinct improvement on the original draft of these sub-clauses, by providing both for a more even flow of replacement and for a quicker replacement of nominated by elected directors.

As regards the general purpose of this sub-clause the non-official members of the Committee have made it clear that they would not consider anything less than 75 per cent. of the voting directors as affording a proper representation of Indians. We have received an assurance on behalf of the Government from the Government members of the Committee that the Governor-General-in-Council will exercise his powers so as to ensure the proper representation of Indians on the first Board.

Clause 17, sub-clause (1).—We think that it is desirable to make it clear that the Reserve Bank can accept money on deposit from local authorities. We have amended the sub-clause accordingly.

Sub-clause (2) (a).—We have added the word “on” to enable the Bank to discount rupee import bills in the event of such instruments coming into existence in the future as contemplated by the Central Banking Enquiry Committee.

Sub-clause (2) (b).—We consider that the period of six months is unduly restrictive in the case of agricultural bills and, following the practice in the United States of America, we have raised the period of six to nine months. We have also omitted the proviso in the original clause as being undesirable in the present conditions of India.

Sub-clause (3).—We have re-arranged this sub-clause and divided it into three sub-clauses 3 (a), (b) and (c). In sub-clause (3) (a) we have restricted the operations of the Reserve Bank to scheduled banks only, as we do not think the Bank would normally require to transact such business with other persons, while we have separately provided in clause 18 for relaxing the restrictions in this sub-clause on special occasions.

On the other hand in sub-clause 3 (b) we have removed any restrictions on the persons with whom the Bank may deal outside India in sterling bills.

We have altered this sub-clause consistently with the recommendation recorded in our note on clause 2 (d) that operations in foreign currency should be restricted to sterling currency of the United Kingdom.

Sub-clause (4).—We consider that in ordinary circumstances dealings under this sub-clause should be restricted to banks, public authorities and Indian States. We have made provision in clause 18 for its extension where this is considered desirable on special occasions.

Sub-clause (4) (b).—We have included silver.

Sub-clause (4) (c).—We have omitted the proviso for the same reasons which led us to omit the proviso to sub-clause (2) (b) of this clause.

Sub-clause (4) (d).—We have omitted this as unnecessary in consequence of the change made in 17 (4) (c).

Sub-clause (4) (e).—We have omitted the proviso because we consider that there is little likelihood of the bill habit developing within five years to such an extent as to make it possible to discontinue this practice within that time.

Sub-clause (5).—We consider that the provision in its original form might lead to undue latitude. In an extreme case it would be permissible for Government to borrow in this way for a period of fifteen months. We consider that such advances should normally, as soon as possible, be converted into treasury bills which should be offered on the open market even though the Reserve Bank may take them up. We have therefore limited the period to three months. We have enlarged the scope of this clause so as to include advances to such Local Governments as may have the custody and management of their own provincial revenues.

Sub-clause (6).—We are informed that bank post bills are not made payable elsewhere than at the office of issue and have amended the sub-clause so as to state the existing practice correctly.

Sub-clause (7).—We consider that in view of the limitation of holdings to securities of the British Government [*vide* our note on sub-clause (2) (d)] this provision is unduly restrictive and that the Bank should be empowered to purchase such securities up to a maturity of ten years. We must make it clear that our intention is that this should be merely an enabling clause and that in practice the Bank should arrange for its holding of securities to be as liquid as possible.

Sub-clause (8).—We consider that the sub-clause as originally drafted was unduly restrictive and would not allow sufficient facilities for open market operations by the Bank. We have therefore modified the amounts in the proviso but wish to make the same point here which we did with reference to sub-clause (7), namely, that these figures are to be regarded as a maximum and that in ordinary circumstances the Bank must keep its security holding as liquid as possible and operate well below these limits. We also consider that, in view of recent floatations by provincial Governments, there is no reason for restricting the maturity of securities of a Local Government to ten years. As regards securities of Local Authorities and of States in India we think it better that instead of limiting these according to their maturity, their eligibility should be subject to the general overriding approval of the Government of India which would enable each particular case to be considered on its merits. We have amended the sub-clause accordingly.

We also wish to provide that where a security is fully guaranteed both as to principal and interest by any authority, it shall be considered for all purposes as the equivalent of a security of such authority.

Sub-clause (9).—We have not restricted the operation of this sub-clause to scheduled banks or public authorities because we consider that there might be cases in which such restriction would operate inconveniently in practice. At the same time we wish to make it clear that in our view this power should not be exercised by the Bank so as to compete in its normal business with the commercial business of other banks. It should be the duty of the Government to watch this and to see that the interests of other banks are in practice protected.

Sub-clause (13).—We see no reason why this should be restricted to sterling standard countries. It is desirable to promote co-operation between Central Banks, and we therefore consider that the Reserve Bank should be empowered to act as the agent of any Central Bank, and *vice-versa*.

Clause 18.—We have added words to this clause so as to make it clear that although the exercise of these powers should not necessarily be regarded as limited to occasions of so critical a nature as to justify their description as an emergency, nevertheless they are not to be used for the normal operations of the Bank and should be restricted to special occasions. We have also modified it so as to provide for the delegation of the powers of the Board to a committee of the Board as well as to the Governor. We have further thought it desirable to make it clear that although in order to make quick action possible the Board may delegate its special powers under this section to a committee or to the Governor, nevertheless such delegated powers should not normally be utilized without previous consultation with the Board, and that if in cases of special urgency such previous consultation is impossible, the members of the Board shall be informed at once so that, if they think fit they can convene a special meeting to have the policy considered and decided.

We have also made amendments consequential on the limitations which we have suggested in our amendments in sub-clause (3) and sub-clause (4) of clause 17.

Clause 19, sub-clause (4).—The word “unsecured” appears to convey very little meaning without qualification and we think that it should be omitted, thus leaving the powers to make loans and advances exclusively regulated by the clauses which give powers in this respect.

Clauses 20 and 21.—We think that it should be made clear that the Governor-General-in-Council should have the final power of decision regarding the terms on which these transactions are to be carried out in the unlikely event of a failure to settle them by agreement. We also consider that the Agreement to be entered into with the Reserve Bank, in view of its importance, should be laid on the table of both Houses.

Clause 21, sub-clause (2).—We have omitted the words “in India.” They appear to us to be unnecessary, because in present

circumstances neither the Governor-General nor Local Governments can, as such, float loans outside India, and, should they acquire this power in the future, an amendment would be necessary, if these words were retained, to have them removed.

Clause 22.—We do not see any need to use the expression “paper money.” We also think that the limitation to one year is unduly rigid and might prove inconvenient in practice, while, on the other hand, we cannot see any objection to the Bank being allowed to use Government currency notes until the stocks are exhausted.

Clause 24.—We consider that the clause in its original form was unduly rigid and might have proved inconvenient.

Clause 25.—We have added a few words so as to make it clear that the primary duty for making proposals as to the form and design of notes rests with the Central Board. We consider that sudden and drastic changes in the design and form of notes should not be made.

Clause 27.—There is at present no machinery for the sterilization of notes and it is unlikely that any will be introduced in view of the comparative simplicity of destroying notes and issuing new ones. We have therefore omitted the first part of this clause.

Clause 28.—We have retained this clause pending examination by a small committee of official and non-official experts, which should meet as soon as possible, of the whole question of the rules regarding payment on lost, stolen or mutilated or imperfect currency or bank notes. We may add that if our recommendation that the Reserve Bank should offer free remittance facilities to scheduled banks between their branches is accepted, the question of the rules referred to above may lose much of the importance that is now attached to it.

Clause 30.—We consider that the remedy proposed in the clause in its original form was inappropriate. If the Bank failed to comply with the requirements of Chapter III or of any other provision of the Act and if, in consequence, it was decided that it should forfeit the right of note issue, it is hardly conceivable that it would command the confidence of the public to such

an extent as to be allowed to remain in charge of the other functions entrusted to it by the Act. We therefore consider that in such circumstances a complete reconsideration of the position will be necessary. It is not possible to lay down in advance exactly what steps will be necessary nor do we feel entitled to assume that the liquidation of the Bank will necessarily and inevitably be the only possible course. We therefore think that the right form of provision is one which will give the Government power to make emergency arrangements and lay upon it the duty of consulting the Legislature at the first opportunity, after which further and permanent measures can be settled. We have drafted the clause accordingly.

We think it important to record our view that if a failure by the Bank to fulfil its obligations under the Acts is the result of a national emergency or a crisis arising from factors over which the Bank had no control, it would be the duty of the Government to use the resources of the State in maintaining the Bank and tiding over the difficulty.

Clause 31.—We have inserted the words “including hundis” after “drafts” in the proviso so as to make the wording of the proviso conform to the wording in the body of the clause.

Clause 32.—The powers of a Presidency Magistrate or a Magistrate of the first class to impose fines are limited to a maximum of Rs. 1,000, so that the wording of the clause as it stood was self-contradictory. We have altered it to make the meaning clear.

Clause 33, sub-clauses (1) and (2).—As we stated in our note on clause 2, sub-clause (d), we consider that the fiduciary external assets should be limited to securities of the United Kingdom.

Sub-clause (2).—Some of us have wished to prescribe (a) for the amount of gold at present held by Government in its currency reserves—namely, about 44½ crores—being retained as a minimum, and (b) for maintaining the gold in the reserves at a minimum percentage of 20 per cent, to the liabilities of the issue department. As against this it has been argued by the Government members (a) that even if it might be thought right as a

matter of policy, at least in present circumstances, not to part with any of the present stocks of gold, nevertheless a statutory prohibition against dealing in any way with any of the gold may prove unduly hampering on the Bank and so weaken its power to defend the position in case of need that in practice the limitation might prove to be not an added safeguard for the preservation of the reserves but an actual source of weakness, (b) that any percentage provision is in present circumstances entirely unsuitable, for it might force the Bank actually to buy gold at times when such a purchase would involve in any case a heavy book loss (owing to the fact that gold has according to the accepted provisions of this Bill to be valued at a price which is about 33 per cent. below its present market value) and possibly an ultimate real loss. Those of us who have supported the former views are prepared to accept a compromise in the form of increasing the minimum to 40 crores and this the Government members have stated that they are prepared to accept as part of a general plan which is in other respects satisfactory.

Sub-clause (3).—We have omitted the words “drawn and” as a consequential amendment to the amendment which we have suggested in 17 (2) (a). We also consider that the limitation of rupee securities might prove unduly restrictive. We have therefore altered the word “less” to “greater” and have made additional provision for a further 10 crores with the permission of the Governor-General-in-Council.

Sub-clause (6).—We have omitted sterling securities of the Government of India. We do not consider that these are assets which could properly form part of the external reserves, and there is no need even for their temporary inclusion.

Clause 35.—We have added a proviso to make it clear that at the time of transfer the whole of the gold coin and bullion held by the Governor-General-in-Council in his reserves should be transferred to the Bank.

Clause 36.—As a result of the provisions of this clause which differ from those of the earlier Reserve Bank Bills, the Government will be left in possession of a large part of the stocks of silver bullion and rupees which it now holds. The policy of disposing of such silver and the methods of accounting for its proceeds involve im-

portant issues which the Legislature should be given an opportunity to consider. We have dealt with this question in the final paragraph to this Report.

Sub-clause (1).—We have altered 1-10th to 1-6th because we consider that, particularly in view of the obligations which we are putting on the Bank in clause 39 to make its notes fully convertible into silver rupees, a proportion of 1-10th is too low.

Sub-clause (2).—For the same reason we have altered “may” in sub-clause (2) to “shall.”

We have also substituted the words “securities of the British Government” for “securities of sterling standard countries” consistently with our proposals under clause 33.

Clause 37.—The small amendments in this clause is consequential.

We have added a proviso to ensure that the minimum gold holding specified in clause 33 (2) shall in any case be retained as the last reserve. We consider that if the currency reserves had to be drawn upon so heavily that they were reduced to 40 crores a situation would have been created which would in any case require reconsideration of the whole position. In that event we think it of the greatest importance that the Bank should possess at least this minimum holding of gold as a nucleus of reserves with which to maintain the currency position on the new basis which might be settled after such reconsideration. It is because we consider that a stock of gold will in such circumstances be the most valuable nucleus that we think this minimum should be preserved in the shape of gold rather than in sterling securities. In making this recommendation we do not imply that a provision of this nature, earmarking a certain portion of the currency reserves for special treatment, is necessarily suitable as a permanent provision, and we recognise that it may have to be reconsidered when the occasion contemplated in the preamble to the Bill arises and it is possible to frame measures for establishing the Indian monetary standard on a permanent basis.

Clause 38.—We have omitted the word “new” which seems irrelevant in this context.

Clause 39.—We consider it essential that provision should be made to ensure the legal convertibility of the notes of the Reserve Bank into silver rupees. Even though on theoretical grounds such a provision might seem undesirable, we feel that it is much more important to ensure that confidence in the notes of the new institution will not be endangered.

It is, in our view, implicit in this clause that the Bank will create sufficient branches, offices and agencies throughout the country to enable it to fulfil its obligations to supply different forms of currency so as to meet the reasonable needs of the public.

Clauses 40 and 41.—In accepting the provisions of these clauses we have read them together with the preamble and have accepted the conclusions of the London Committee which we think it advisable to restate:—

“In the prevalent state of monetary disorganization throughout the world, it is impossible to incorporate in the Bill provisions which would necessarily be suitable when monetary systems generally have been recast and stabilised. In these circumstances we consider that the only sound course for India is to remain on the sterling standard. On this basis the exchange obligations incorporated in the Bill must necessarily be in accord with the rupee sterling ratio existing *at the time when the Bill is introduced*. The statement does not, however, imply any expression of opinion on the part of the Committee on the merits or demerits of the present ratio. The ratio provisions in the Bill are designed to make it clear that there will not be any change in the *de facto* situation by the mere coming into operation of the Reserve Bank Act.”

The Government members have made it clear to us that their intention in introducing this Bill is merely to create the machinery of a Central Bank and not to ask for any special confirmation from the Legislature of the present ratio. We are prepared to accept the view therefore that the ratio issue does not arise in the present Bill.

Clause 41.—We have added the second proviso with a view to protect the interests of the Bank.

Clause 42.—This is a wide and very difficult clause as it covers entirely new ground and the conditions in India are so diverse that its provisions must be regarded as tentative and may have to be modified by legislation after practical experience has been gained. We have had particularly in mind a certain modification in the form of an extension of the scope of this clause and for this reason have added a new clause 49-A making it incumbent on the Bank to submit proposals for legislation with particular reference to the conditions of indigenous banking.

Apart from this, we consider that the clause in its original form would have been likely to prove unduly rigid in its operation; and in particular that to calculate the average holdings of the scheduled banks from monthly returns might have involved the imposition of penalties in an inequitable manner. We have therefore substituted weekly returns based on the actual figures of a particular working day. We discussed the percentages of $7\frac{1}{2}$ and $2\frac{1}{2}$ with the banking experts. They thought that those proportions were too high but agreed that 5 and 2 would be practicable. We agree and have reduced the proportions accordingly. We further recommend the exclusion of certain liabilities of a more or less technical character from the liabilities on which the minimum deposit has to be calculated. In addition we consider that loans from the Reserve Bank should be excluded from the liabilities as calculated.

In sub-clause (7) we have come to the conclusion that the limit of 3 lakhs is too low and might result in the inclusion of petty firms which do not really fall within the intention of the section. We have therefore increased 3 lakhs to 5 lakhs. We considered whether it would be possible to include together with capital and reserve the amount of deposits as a criterion but came to the conclusion that they are so variable that this would be impracticable. In our view any alteration on these lines must be considered in the light of practical experience. We also consider that when the question of the inclusion of companies is being considered, special care should be taken that companies are not included which are not performing what is really banking business. This should not be difficult for the Bank to decide with reference to each particular case, though it is difficult to draft a general definition of what is banking business and we have not attempted to do so. It may later be

found, as a result of practical experience, possible to incorporate such a definition in the statute. We have made consequential amendments in the Second Schedule but we would emphasise the fact that the Schedule is merely illustrative and that it has been compiled on admittedly inadequate material. After the passing of the Bill early intimation should be sent to the companies included in it or to any others the inclusion of which would seem to be indicated by later statistical returns so as to give them ample time to show cause if they consider that they should not be included.

In connexion with this clause we have also considered several representations made by banks and other parties. One is that the repayment of these compulsory deposits should be guaranteed by Government. We are not prepared to recommend such a provision. It was also suggested that savings bank deposits should be reckoned as time liabilities for the purpose of calculations in sub-clause (1). We consider that the terms on which savings banks are run by various banks vary so widely that it would be impossible to frame any general rule.

In view of the fact that the Reserve Bank will only have a few offices of its own, it will obviously be necessary for the scheduled banks to keep accounts with the Reserve Bank at branches of the Imperial Bank as agents for the Reserve Bank. Balances held on such accounts will of course be taken into account in calculating the amount of any scheduled banks' deposits with the Reserve Bank.

Sub-clause (4).—We are informed that it may be difficult for banks in certain parts of the country which have branches in the interior having no easy communication with their head offices to submit the returns prescribed in this clause within the allotted time. We have provided that in such cases the Reserve Bank should have power to extend the period for the submission of the returns.

[SECTION 43] *Clause 42-A.*—We consider that a consolidated statement based on the returns collected under clause 42 should be published on the ground that they should be of interest and value to the public. Though the returns of individual banks must obviously be regarded as highly confidential, this consideration does not apply to statistical returns compiled from them all.

To make the returns more complete for statistical purposes we consider that the Government should also furnish the Bank periodically with figures of the amounts of rupee coin, subsidiary coin and notes held at treasuries and sub-treasuries.

[SECTION 44] *Clause 42-B.*—We considered whether provincial co-operative banks should be included in the Schedule, but came to the conclusion that though there may be considerable advantages in such a course, the time is not yet ripe for it. We consider, however, that if co-operative banks are to be given the facilities indicated in clause 17, they should submit the same returns as those prescribed for scheduled banks so as to enable the Reserve Bank to see that they are maintaining a satisfactory position.

[SECTION 45] *Clause 43 and the Third Schedule.*—We have given very careful consideration, after discussion with the representatives of the Imperial Bank and other bankers, to the various issues involved in the Agreement to be entered into between the Reserve Bank and the Imperial Bank of India. We think it necessary to record our views under the following three main headings:—

(a) *Remuneration for handling Government Account.*—On the basis of the figures supplied to us we have reached the conclusion that the terms suggested are reasonable and represent no more than is necessary barely to cover the actual cost incurred by the Imperial Bank in performing these services. We are assured by the Government representatives that these figures were based on detailed and audited statements supplied by the Imperial Bank and accepted by the Finance Department after careful examination of the method of distribution of over-head charges. We think, however, that it would be satisfactory to the Legislature that the basis on which the costs have been calculated should be independently examined by the Auditor-General and that a report by him should be presented by the Government when these provisions of the Bill are under discussion indicating whether in his view the basis on which the costs have been calculated is reasonable and the results of the calculations correct.

(b) *Compensation for the keeping open of branches.*—We consider that the method proposed in the Schedule of keeping specified minimum balances with these branches either free of interest or at

concessional rates is not a satisfactory method for fixing compensation under this head, for the value of such balances must vary greatly according to the rates obtainable for the use of money. It appears to us much more satisfactory that a definite annual payment should be made, based on the losses actually incurred. At the same time it would not be justifiable to settle this compensation for a long period on the basis of present results because it must be anticipated that with the general development of banking in India these branches will become progressively more remunerative. We therefore propose a diminishing scale leading to a termination of all compensation after 15 years. We consider that the figures proposed are reasonable on the basis of the statements supplied to us as to the actual cost of maintaining these branches but in this case also we recommend that an independent check on the calculations should be made by the Auditor-General and included in the report already referred to.

(c) *Period of agreement.*—We have taken into account the fact that as the compensation for maintaining the unremunerative branches would terminate after 15 years, there would be some advantage to the public in continuing the Agreement beyond 15 years so as to prolong the period during which the Imperial Bank remains under an obligation not to close any of these branches. On the other hand, we consider, first, that a period of 15 years is in any case too long for a commitment of this important nature, and, secondly, that inasmuch as the commission payable for handling Government Account is intended to be based on the actual cost of the services rendered, the rate of commission should be open to recalculation at a comparatively early date. Taking all the foregoing considerations into account, we recommend that the Agreement should run for 15 years subject to termination on five years' notice given at any time after that period, and that the commission payable for handling the Government Account should be reviewed at the end of ten years and thereafter at five-yearly intervals. It should be made clear that the object of such review would be to settle the actual cost to the Imperial Bank, that the commission should be settled on this basis, and that the calculations shall be subject to expert accounting investigation. In the event of any difference of opinion as to terms arising between the Reserve Bank and the Imperial Bank, we recommend that power to settle the terms finally should be vested in the Governor-General-in-Council.

In view of all the arrangements as regards staff, etc., involved we consider that a period of five years for notice of termination is no more than reasonable.

Lastly, there is one important point which should be made clear in this agreement, namely, that it should not in any way preclude the Reserve Bank from opening its own offices or branches at any place where the Central Board may, as a result of experience, find this to be expedient in the interests of the public notwithstanding the fact that the Imperial Bank has up to then acted as its agent at such places.

[SECTIONS 46 & 47] *Clause 43-A and Clause 44 (included in Chapter IV).*—We think that the provision in clause 44 for the building up of a Reserve Fund would throw an unnecessarily heavy initial burden on central revenues. At the same time we consider it highly desirable that an adequate Reserve Fund should be available to the Bank in its early years, the main purpose of such a Reserve Fund being to provide a margin against possible depreciation in securities held either in the Issue or Banking departments of the Bank. After careful consideration we have come to the conclusion that the most satisfactory solution would be for Government to start the Bank with the full reserve proposed in the Bill by making over to it the sum of 5 crores in short-dated Government securities—probably treasury bills.

The arrangements for distribution of profits should then provide that this Reserve Fund will always be maintained at the figure of 5 crores.

This change does not involve any substantial recasting of the provisions of the original Bill, all that is necessary being to omit that part of the provisions which covered the period until the reserve had been built up to 5 crores. We have amended the clause accordingly and also included a provision for the initial transfer of the 5 crores Fund by Government, so that this transaction may be covered by a vote of the Legislature.

[SECTION 48] *Clause (44-A).*—We consider it desirable to make provision for the exemption of the profits of the Bank from income-tax and company super-tax, while at the same time providing that the shareholders will have to pay income-tax on the dividends which they actually receive.

[SECTION 49] *Clause 45.*—We think it desirable that the Bank should have power to discount agricultural bills at concessional rates which may be below the rate for the purchase or rediscount of commercial paper. We have therefore altered the words “minimum rate” in this clause to “standard rate.”

[SECTION 51] *Clause 47.*—We think that the Governor-General-in-Council should also have discretion to appoint the Auditor-General as auditor under this clause if he so desires. We have amended the clause accordingly.

[SECTION 53] *Clause 49.*—We have provided that the annual accounts transmitted to the Governor-General-in-Council by the Reserve Bank should be accompanied by a copy of the Directors’ report on those accounts.

[SECTION 54] *Clause (49-A).*—Though we consider it important that a start should be made on the lines indicated in clause 42, we recognize that the developments at this stage must be tentative. We therefore consider it important that a statutory provision should be included, making it incumbent on the Bank to report at the earliest practicable date and in any case within three years and, if necessary, to prepare proposals for legislation so as to include indigenous bankers and other parties doing banking business in India who are not at present included in the Schedule within its scope subject to such restrictions as the Board may consider necessary. In this report it should also include proposals for the closer linking of agricultural enterprise with the machinery of the Reserve Bank, possibly by the establishment of a separate rural credit department.

We also think that in this clause it would be desirable to include a provision embodying in a more concrete form the principle recognised in the preamble, by placing a definite obligation on the Board to put up proposals for a more permanent currency system for India when they consider that the prerequisites indicated in the preamble have been fulfilled, that is to say, the international monetary position has become sufficiently clear and stable.

[SECTION 56] *Clause 50, sub-clause (5).*—We have added this sub-clause to fill up a lacuna in the clause as originally drafted.

[SECTION 57] *Clause 51.*—Some of us are of opinion that the

Governor-General-in-Council should have power to purchase the shares of the Bank at the end of 25 years if in the interests of the country it is then considered desirable to run the institution as a State Bank.

Clause 51, sub-clause (1).—This sub-clause as originally drafted left it doubtful in whom the power to initiate liquidation proceedings was vested.

Sub-clause (2).—We have added a proviso to limit the amount of the surplus assets which would go to the shareholders in the event of liquidation of the Bank in the early years. We consider that, without some limitation of this nature, the shareholders might, particularly as a result of the proposals mentioned in the note on clause 44 for starting the Bank off with a Reserve Fund of 5 crores, be placed in an unduly favourable position in the event of early liquidation of the Bank. Unlikely though that contingency may be, we have thought it necessary to provide for it. It will be noted that according to the original proposals in the Bill shareholders would have been entitled to receive 25 per cent. of the “surplus assets” on liquidation, and as according to the proposals for distribution of profits these surplus assets could hardly have exceeded the maximum amount of the Reserve Fund, namely, the amount of the share capital of the Bank, the shareholders would under the original proposals also have had no expectation of a higher profit on liquidation than 25 per cent.; and this position would only have been attained after several years of working.

[SECTION 58] *Clause 52, sub-clause (2) (mm).*—We have added the power to make regulations regarding the fees to be paid to Directors and to members of the Local Boards.

Sub-clause (2) (mmm).—We think it desirable to make special provision for regulations regarding the relations of scheduled banks with the Reserve Bank. In particular, it may be found necessary or desirable for the Reserve Bank to call for further information from them.

Sub-clause (2) (mmmm).—Though the management of clearing houses is one of the usual functions of a Reserve Bank, we think that it would be as well to make specific provision for the regulations which the Bank will issue in this matter.

Sub-clause (3).—We have added this sub-clause to make it clear that copies of any such regulations will be available to the public on payment.

4. The Government put before us a memorandum which we have attached to this Report [Appendix A] containing their proposals for dealing with three important matters which were recommended for further consideration in India by the Committee which considered the Reserve Bank proposals in London. These matters are:—

- (1) The method for dealing with the surplus stock of rupees which are at present held in the Government's currency reserves, but which will under the plan embodied in the present Bill be retained by Government.
- (2) The amount of external reserves which should be handed over by Government initially on the formation of the Bank.
- (3) The method for dealing with any profit or loss which may result from a revaluation or a sale of the stocks of gold to be handed over to the Bank by Government.

The first of these questions arises as a result of the general plan embodied in clause 36 of the Bill—the effect of which is that, contrary to the plan embodied in the earlier Bills, Government will retain the responsibility in connexion with the silver coinage so that the Bank will not have to carry stocks of silver coin surplus to its own requirements, or be concerned with sales or purchases of silver bullion or any loss which such transactions may involve. While we are prepared to state that we approve of this general plan, we have not had time fully to consider the details of the Government's proposals as regards the methods for dealing with the stocks of silver to be retained by Government nor as regards the matters arising under the other two heads. In the circumstances, as we are bound to present our report on the Reserve Bank Bill by November 20 and shall by that act have completed the function laid upon us by the Legislature in this matter, we can only recommend that the details of the Government proposals should be further studied by the Legislature by such means as it thinks fit.

APPENDIX A.

MEMORANDUM BY THE GOVERNMENT REGARDING DISPOSAL OF SURPLUS SILVER.

In paragraph 21 of the report of the London Committee on Indian Reserve Bank legislation they made certain recommendations regarding the transfer of rupee coin between Government and the Bank which have been embodied in clause 36 of the Reserve Bank of India Bill, 1933, and as regards certain matters arising out of these recommendations the Committee proposed that they should be further examined in India.

(a) Heading (2) of the arrangement recommended was as follows:—

“Any surplus of rupees which this arrangement would enable Government to remove from the reserve should be held by Government in a separate account, the silver being held as bullion, not as coin. *Subject to further consideration by the Government of India* any proceeds from the realisation of such rupees should not be used, except for the purpose specified in (3) below.”

The purpose thus specified was the “payment of full value” (40 per cent. in external assets) for any further surplus rupees transferred by the Bank to the Government.

(b) The concluding recommendation of paragraph 21 was as follows:—

“We do not propose any alteration in the figure (of external reserves) in the new Bill, but we think that this proportion may not necessarily be adequate and we recommend that the question whether a higher proportion is required at the outset should, before the Bank is set up, *be carefully considered by Government* in the light of all the prevailing circumstances.

2. In paragraph 25 of their Report they also remarked:

“The possibility would obviously be present that the Bank might gain a large premium on the gold handed over to it by Government. The question as to how such premium

should be dealt with, specially in the event of sales being made in the intermediate period pending revaluation of the gold, raises complex practical issues which we have not fully discussed. - In principle such profits should belong rather to the Government than to the Bank, but our view is that this unrealized margin should in some way or other be kept available for strengthening the position of the currency reserves. *We recommend that detailed proposals should be worked out by the Government of India for consideration during the passage of legislation on this subject.*"

3. The points thus referred for further examination raise two problems which are closely connected and which, in the opinion of the Government of India, should be treated together. The following appear to be the main considerations which should be taken into account:

(a) The proceeds of any sales of the surplus silver (to be retained by the Government under the arrangement proposed) and of any surplus realized on the sale or revaluation of the gold (to be transferred to the Bank) would represent assets originally accumulated against the issue of currency and as part of the ordinary currency business of Government. Such assets should therefore be regarded as primarily earmarked for currency purposes.

(b) It does not however necessarily follow that such assets should be directly or immediately absorbed in the currency reserves of the Bank, because—

- (i) The Government must retain a separate reserve against the liability imposed upon it to pay full value for further surplus rupees which it may be required to take over from the Bank under the proviso to sub-clause (1) of clause 36 [Cf. also the recommendation of the London Committee referred to above in paragraph 1 (a)].
- (ii) Reasonable account must be taken of the general financial position of the Government which may react on the currency position. Looking at the matter from a practical point of view, it may not be good policy to accumulate excessive funds in specially earmarked reserves, be-

cause in the first place this may involve a substantial loss of interest seeing that in normal circumstances it will only be possible to earn a much lower rate of interest on such funds than the Government has to pay on its own public debt, and, in the second place, the general effect on India's credit of repaying outstanding loans may be of greater value than adding to the accumulated reserves (*Cf.* as an actual example in the past the repayment by the Government of India from its own resources of the £ 15,000,000 sterling loan in January 1932).

- (iii) If the Bank is started off initially with reserves in gold and sterling assets which afford amply adequate cover against its issue liabilities, the addition from outside of still further external assets would serve no useful purpose and might even put the Bank into a position of being able with undue ease to expand the currency against rupee assets when that was not justified.

4. The Government of India have carefully weighed the above considerations and I am directed to place the following scheme before the Committee for its consideration:—

(a) The silver which will be retained by Government, whether in rupee coin or bullion, should be regarded as stock purchased by Government from its Currency Department. On the basis of the accounts of the Currency Department on the 31st August 1933 (at which date the silver stock attained the maximum point reached during the current year) Government after handing over 50 crores of rupees to the Bank would retain rupees and silver of a nominal value of 55,41 lakhs would be set off the value of the assets of the Gold Standard Reserve, 53,33 lakhs, so that the net debt against the silver thus retained by the Government would be the difference between these two figures, namely, 2,08 lakhs.

(b) The proceeds of any sales of silver after the transfer would be credited to a separate fund more or less on the lines of the present Gold Standard Reserve which it is suggested might be called the "Silver Redemption Reserve." This reserve would be invested by Government in its entirety in gold or sterling securities.

(c) The book loss on sales of silver since the commencement of selling operations is approximately 31,63 lakhs,* and this figure must also together with the 2,08 lakhs mentioned under (a) be regarded as a debt incurred against silver. To this debt will also have to be added the full nominal value of any silver rupees returned by the Bank under clause 36 (1) of the Bill, while the full nominal value of any rupees sold to the Bank under clause 36 (2) will be deducted from it. The loss of 31,63 lakhs already incurred is at present held in a suspense account and it will continue to be so treated. Interest and amortisation provisions against the debt represented by this loss and the 2,08 lakhs balance of silver to be taken over together with any further silver which may be taken over will be made in the manner described in the following paragraphs.

(d) Interest on the outstanding loss which is in fact represented by a corresponding portion of the public debt (namely, treasury bills in the Paper Currency Reserve) is at present met out of the revenues of the Government of India. This should continue both for the outstanding loss and any other additions to the silver debt referred to above, but the Government of India should be allowed to set off the interest which it receives from the investments in the Silver Redemption Reserve. In other words, the interest on this reserve will not be added to the reserve but will, as at present, accrue as a receipt to Government revenues.

(e) Provision will also have to be made for the amortisation of the outstanding "silver debt." At present no provision is made for the amortisation of treasury bills held in the Paper Currency Reserve so that in practice there is no amortisation provision for the debt representing losses on account of silver. The Government of India consider that some provision should be made but any plan for this must be dealt with as part of the Government's general plan for Sinking Fund provisions on the public debt—a question which must be dealt with separately.

5. It remains to consider how the funds which would accumulate in the Silver Redemption Reserve should be utilized. The

* This is not really in the true sense a loss. It is the figure which represents the difference between the price of the silver sold as bullion and the face value of the rupees from which the silver was produced. In order to get a true picture of the position there must be balanced against this nominal loss the profits which the Government originally made when the rupees were put into circulation from which profits *inter alia*, the £40 millions Gold Standard Reserve was built up.

considerations affecting this question have been set out in paragraph 3 above. Weighing up the various considerations, the Government of India consider that it would be a reasonable arrangement to allow the Silver Redemption Reserve to accumulate until it reached a total of 10 crores. Any further receipts should not be separately invested but should be taken direct into Treasury balances to reduce the outstanding "silver debt" described in paragraph 4 (c), i.e., to be utilized for the reduction of debt either by the redemption of existing debt or the avoidance of new borrowing. A reserve of 10 crores in external assets would allow for a return of 25 crores of rupees by the Bank to Government, that is to say the maximum amount which could be returned in five years. This should be adequate for all practical purposes and against locking up funds beyond this reasonable margin must be weighed the consideration mentioned on paragraph 3 (b) (ii) above.

6. As regards the second recommendation of the London Committee [paragraph 1 (b)] of this Memorandum, the Government of India do not consider that it would be practicable at present to decide whether and, if so, to what extent the Bank should be provided with external cover in addition to the 50 per cent. indicated in clause 35 of the Bill. It is of course understood that the whole of the Government's gold holding will in any case be handed over. Apart from this, if there should be any margin of other external assets which the Government at the time when the Bank is set up did not consider it necessary to hand over to the Bank and which it would consequently retain for its own purposes, the Government of India provisionally consider that the most suitable alternative method for appropriating any such surplus would be to transfer it as an opening balance to the Silver Redemption Reserve proposed above.

7. As regards the third point in paragraph 25 of the London Report (vide paragraph 2 of this Memorandum), the Government of India do not consider it necessary to make any specific proposals regarding the utilization of any hypothetical profits on the revaluation of gold. Such profits might arise in two ways:

(a) There might be sales, in which case there might be a considerable premium representing the difference between the market price and the statutory price as indicated in clause 33 (4) of the Bill.

(b) When the time comes to adopt a permanent currency standard as contemplated in the preamble to the Reserve Bank Bill, the new valuation as compared with the valuation at the old parity as adopted in clause 33 (4) might be such as to show either a paper gain or loss.

8. As regards alternative (a), sales are very unlikely and unless they were for a very large amount, the profit on them would not be sufficient to alter the dividend payable to the shareholders, in which case the whole of the profit on such sales would accrue to Government under clause 44. The Government of India do not consider it necessary to legislate for this highly hypothetical contingency.

9. As regards alternative (b), if there was a revaluation, clause 33 (4) of the Bill would require amendment, in which case it would be open to the Legislature to make a further amendment of the Bill so as to ensure that the whole of the profits or losses on such revaluation would accrue to or be borne by Government. If there were profits, the actual manner in which any such hypothetical profits would be utilized is a still more hypothetical question on which it appears to the Government of India to be even less necessary to formulate any specific scheme. It is obvious that any such paper gain should not be swallowed up in ordinary revenues but should be devoted to some currency purpose and this most probably would take the form of an additional fortification of the Silver Redemption Reserve. That, however, is a matter which could be left to be decided at the time.

10. The Government of India therefore do not consider that any provision need be made in the present Bill with respect to these recommendations of the London Committee, but they would suggest that a note might be made in the report, possibly on clause 33 (4), on the lines indicated in the preceding paragraph, regarding the utilization of any book gain or loss on gold, while they would also be glad to have the views of the Committee on the scheme for a Silver Redemption Fund set out in paragraphs 4 and 5 of this Memorandum.

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