

AN ACCOUNT
OF THE
PRESIDENCY BANKS

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INDIAN CIVIL SERVICE.



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PREFACE.

IT is believed that no complete account of the Presidency Banks has hitherto been published, though a few particulars of their early history are to be found in Cooke's "Banking in India", a book published in Calcutta in 1863, and long since out of print. The following memorandum deals with the history of the Banks from their institution to the present date, but as it is mainly based on Government records it is to be regarded rather as an account of their relations with the Government than as a complete narrative of their career. Through the courtesy however of Mr. W. D. Cruickshank, the Secretary and Treasurer of the Bank of Bengal, the writer has been enabled to considerably amplify the account of the senior Presidency Bank. In particular, the details given of the history of that Bank up to the year 1843 are derived almost entirely from selections from its records which Mr. Cruickshank kindly placed at the disposal of the Government of India. The writer warmly acknowledges the assistance he has thus obtained.

He also wishes specially to acknowledge the valuable advice and suggestions he has received from Mr. A. M. Lindsay, C.I.F., the Deputy Secretary and Treasurer of the Bank of Bengal. Though the complex questions with which Mr. Lindsay's name is specially associated are not discussed in the following pages, it has been a great advantage to the writer to have Mr. Lindsay's help in preparing a statement of the facts with which those questions are so intimately connected.

CALCUTTA ;

1st March 1900.

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PRESIDENCY BANKS.

CHAPTER I.

THE BANK OF BENGAL—FIRST PERIOD, 1806—1862.

The circumstances which led to the creation of the first Presidency Bank are thus described in a report* published in 1869:—

“At the beginning of this century the European mercantile community in India was small, and consequently when the Government wished to raise large sums of money for the wars in which they were constantly engaged, they were obliged to look chiefly to the native mercantile community for the money required. The mode of raising money in those days was by the issue of what were called Treasury Bills, and these bills, in consequence sometimes of a scarcity of coin and more frequently of a combination among the native brokers, could not be cashed, except at a heavy discount.” It was suggested in 1801 by Mr. Tucker, the Accountant General at Fort William, that “the establishment of a bank, besides securing many commercial advantages, would prevent this depreciation of the Government bills, by introducing a new customer into the market, who would always be provided with a store of specie.” As long before as 1787 the Court of Directors had prohibited the Government

* The report of the Commission on the failure of the Bank of Bombay.

from extending their support to Banking institutions in Calcutta, and in 1805 they negated a suggestion for the establishment of a Government Bank at Madras. Nevertheless the Government resolved to support Mr. Tucker's scheme, and "in 1806 recommended the Court of Directors to establish a Bank in Calcutta, in which the Government was to have the power of nominating the Directors and to be holder of a large portion of the share capital as well as a trustee for the shareholders, guaranteeing the responsibility of the establishment." The Court of Directors thereupon carefully reconsidered the question "and in an elaborate despatch, dated 9th of September 1807, expressed their wish to see a Bank established upon safe principles, but declined to give the guarantee of the Company for its stability. They objected to the principle of the Government becoming a partner in the Bank, but nevertheless added that, if their consent were thought material to the formation or success of the institution, they would acquiesce, and concluded by leaving the Government of Bengal 'a latitude' to subscribe to the extent of ten lakhs towards its capital."

The consent thus reluctantly given was anticipated, for the present Bank of Bengal actually opened (under the name of the Bank of Calcutta) on the 1st May 1806, with a capital of 50 lakhs, of which 10 lakhs had been contributed by the East India Company. Pending the formal approval of the authorities in England its business was conducted under a provisional arrangement.

The Bank received its charter of incorporation, duly confirmed by the Court of Directors, in 1809. The terms of this first charter are indicative of the special objects with which the Bank was created. The amount of stock which might be held by single proprietors was limited to one lakh, to prevent an establishment which the Government had founded for the general advantage from falling into the hands of a few monopolists. The advances to individuals were also limited to one lakh, to ensure the use of the capital for the greatest benefit of the greatest number, as well as for the Bank's greater safety. The restriction of the Bank's advances to Government to five lakhs is

less * easy to understand. The author of the scheme had declared his object to be to combine the advantages of purely private Banks with those peculiar to the State Bank "established under the immediate control and guarantee of the Government," and he seems to have feared that a Bank which owed its existence to the Government, and was under Government control, would lose its distinctively commercial character, if it were also allowed to "implicate itself too deeply in transactions with the Government." The condition that the Bank should not hold more than 25 lakhs of Company's paper in its own right was apparently inserted with the same object. The Bank's rate of interest was limited to a maximum of 12 per cent, in accordance with the Government's purpose of bringing about a permanent reduction in the rate of interest. It was intended that the Bank should not interfere with any established business, and it was therefore prohibited from engaging "in trade or in any kind of agency for the buying and selling of public securities or of goods."

The most important precautionary measures were provisions requiring the maintenance of a cash reserve of at least one-third of the outstanding liabilities payable on demand, and limiting the total liabilities of the bank of all kinds to the amount of the Bank's capital. This last rule had the effect of restricting the note issue to 50 lakhs, or even less, as deposits and all other liabilities were included in applying the limit.

The Government also reserved to themselves ample powers of control. They were represented on the direction by three of their own officers, in confidential communication with themselves, through whom they could bring strong pressure to bear on the Directors if they could not absolutely dictate the policy to be pursued. They also had the right to call for the Bank records

* This restriction was probably borrowed from the constitution of the Bank of England. The Statute of 1695 prohibited that Bank from making advances to Government *without the express permission of Parliament*. The restriction was one limiting the powers of the Crown as much as those of the Bank. Pitt got this provision set aside in 1793 and his constant demands on the Directors for advances involved the Bank in the utmost difficulty and peril. The recollection of this must have been fresh in the minds of the founders of the Bank of Bengal. Again, the Bank of England was prohibited from charging a higher rate of interest than 5 per cent till the modification of the usury laws in 1839. Other points of resemblance in the constitutions of the two Banks could be referred to.

and to appoint an officer to inspect them, and "to require of the Directors any information which they might think fit to require respecting the affairs and transactions of the Bank and the state thereof." Lastly, the office of Secretary and Treasurer was held by a Covenanted Civilian almost continuously up to the time of the Mutiny.

The Bank appears to have been conducted in too complete accordance with the intentions of its constitution, for it was only in 1817 that the Directors discovered that by maintaining a rate of interest of only 6 to 8 per cent when money was very scarce they were playing into the hands of the shroffs, who took the Bank's money at this rate and lent it out "at an enhanced and exorbitant interest." "To prevent the frequent recurrence of so serious an evil as the total cessation of Bank business" it was decided that the rate should be made to "fluctuate according to the demand for money."

In 1822 the Directors asked the Government to sanction the increase of the Bank's capital from 50 to 100 lakhs, the reduction of the cash reserve limit to one-fourth of the outstanding liabilities, and the removal of the restriction which prohibited the Bank from issuing notes to an amount in excess of its capital. This restriction the Governor General in Council admitted to be "plainly preposterous," and the next Charter, which was given in 1823, permitted a note issue up to four times the Bank's capital. The proposal regarding the cash reserve was also agreed to. But these measures were considered by the Government to obviate the necessity for an increase of capital, and this part of the Directors' request was negatived. The delay involved in a reference to England was considerable in those days, and it was not till 1829 that the Court of Directors confirmed the Charter of 1823, stipulating, however, that the capital should be increased by 20 lakhs. By that time the Bank itself was unwilling to increase its capital, and a further reference to the Court of Directors was not disposed of till 1835, or thirteen years after the point under discussion had arisen.

The following figures, which are taken from a letter of January 1820, show the "average state of the funds of the Bank"

during the period of 13½ years in which the first charter was in force :—

	₹	₹
Capital	50,00,000	
Bank notes outstanding	43,58,000	
Accounts current	4,96,000	
Lotteries, Premia and Sundries	4,25,000	
	<hr/>	1,02,79,000
Cash balances	28,98,000	
In Company's loan paper	37,64,000	
Treasury notes	8,99,000	
Loans to the public on deposits	17,28,000	
Bills discounted	9,88,000	
	<hr/>	1,02,79,000

Average dividend 9 per cent per annum.

The low figures under the heads "Accounts current" and "Bills discounted" are noticeable. The accumulation of the information which enables a bank to transact a large discount business with safety is a slow process, and it was not till 1866 that what would now-a-days be considered a fair proportion of the bank's resources was employed in the discount of bills.

There is little of interest to record in the next few years. In 1829 the Rajkissen Dutt forgeries occurred. The Bank had advanced money on some Company's paper which had been certified as genuine by the Treasury before being accepted by the Bank, and which probably did bear the genuine signature, fraudulently obtained, of the Financial Secretary to Government. When it was subsequently discovered that the paper was forged the Government declined to make good the loss of 3½ lakhs, which the Bank had suffered. The case was carried by the Bank to the Court of Directors and the Privy Council but without success, and in 1834 the Directors had to write off the whole amount, with the result that no dividend could be declared, and the Bank's shares fell temporarily from 60 per cent premium to par.

Meanwhile the Bank and Calcutta generally had been passing through difficult times. Between 1829 and 1832 there were several severe commercial panics consequent on the failure of some of the largest of the Calcutta houses. The Bank itself appears to

have been in no great danger, but stepped in to protect one of the most important firms which still remained, and in so doing deliberately infringed its Charter. To this firm (Messrs. Alexander & Co.) the Board directly or indirectly advanced more than 23 lakhs, the extreme limit permitted by the Charter being one lakh. After the advances had been made they accepted some indigo concerns as collateral security, though the Charter prohibited the lending of money on the security of immoveable property. Finally, when the firm failed in December 1832, the Directors worked the indigo factories themselves, being unable at the time to sell them to advantage. This again was contrary to the provisions of the Charter, which expressly prohibited the Bank from engaging in trade. The Government Directors had concurred throughout in the action taken, without apparently even mentioning the matter to the Government, and when, after all was over, an explanation was called for, they joined with the mercantile Directors in defending their course of action as the only policy they could properly have pursued. "The occasion was one," they said, "which called for extraordinary and prompt aid, and though they were aware of the literal objection in their Charter Deed to an advance in excess of one lakh of rupees to any one party on simple personal security, they did not decree the spirit of the Charter to be opposed to a contingency which it could never have contemplated." Elsewhere it is stated that the rule limiting advances to one lakh had been "avowedly and openly contravened" from the first.

Though the Bank was not apparently imperilled, it suffered considerably during these years, the amount written off as bad debts from 1829 to 1835 being 4½ lakhs of rupees (exclusive, it would appear, of the losses on the Rajkissen Dutt forgeries).

The Governor General of the time took an amazingly lenient view of the extraordinary failure of the Government Directors to perform their obvious duty. In an interview with the Secretary of the Bank, "His Lordship observed that the indigo factories held by the Bank ought not to be sacrificed, nor were the Directors to suppose that the communication recently made to them by Government was intended to

interfere with any arrangement which certain previous irregular proceedings had made expedient and necessary for the recovery of its debts—the Bank was in a scrape and should be allowed to get out of it in the best way it could.

“His wish was to let the Bank down as softly as possible. He was of opinion that the Bank Charter required revision; it was neither adapted to the circumstances of the country at large nor even to those of Calcutta; that clause of the Charter which limited advances to one lakh of rupees he thought absurd: it placed the Official Directors who had no personal interest in such proceeding under the necessity of compromising their responsibility by allowing unauthorized advances which might nevertheless be judicious and proper.

“His Lordship was of opinion that a new Charter should be framed adapted to the circumstances of the country: it should be made practical and practicable, and it would be the particular duty of the Official Directors to see that its rules were never violated.

“His Lordship obligingly observed that the newspaper remarks which had recently appeared respecting the conduct of the Bank Directors had given him a favourable impression of their management.”

To such encouragement the Directors were quite ready to respond, and about this period we find numerous proposals under discussion for extending the operations of the Bank and enlarging its freedom of action. Thus, in this year (1833), the suggestion was made that the Bank should take over the disbursement of all civil and military payments at the Presidency town. A decision was delayed owing to difficulty in the settlement of terms, and the Government finally declined the Bank's offer in 1837 on the ground that no appreciable saving would be effected thereby. The proposal, as is well known, was actually carried out 25 years later.

The Directors themselves had not entertained the proposal without some hesitation. The transfer of Government business would have involved a large increase in routine work, and the routine

work they already had was badly performed. The minutes written by the Directors mention that it often took three days for an applicant for discount to get an answer, a whole day to obtain a loan on even the best security—that of Government paper, and four or five hours to get it paid off. The elective Directors freely expressed the opinion that the “Bank will never be what it ought to be while its principal officer (the Secretary and Treasurer) is a Government servant who only looks to the Bank as a stepping stone to something better”; and contrasted their procedure with that of the private Banks where “a discounter gets his money by taking a chair for five minutes and his redeemed paper without any delay at all.” The papers contain several other indications of the unpopularity of the official Secretary among the Directors, and in 1840 a non-official was appointed in spite of the protest* of the Government. But between the elective and Government Directors there appears to have been no friction at all. The latter identified themselves fully with the interests of the Bank and were able to hold their own in discussing and even initiating schemes for its advancement.

An example of this, which also illustrates the spirit of enterprise prevailing at this time, is found in an able minute written in 1837 by Mr. Dorin, an Official Director who had previously been Secretary of the Bank and subsequently rose to the position of Member of Council. Dealing with a proposal for the opening of a branch in the North-Western Provinces, he declares and explains his preference for the more tempting prospects offered by the establishment of branches at Bombay and Madras. Turning then to the question of ensuring the convertibility of

* The Government informed the Bank that relying on the appointment of a Civilian to this post they had given the Bank power to open branches and had “prosecuted the important experiment to what extent a paper currency can safely and conveniently be introduced into India (i.e., in the interior) and were prepared to have continued measures to the same end through the same agency . . . but (if a non-official were appointed) it would be necessary either to relinquish altogether such intention or to devise an agency more subject to the control and more entitled to the confidence of the Government, because managed ministerially by an officer of the Civil Service.” The Bank replied that the improvement in the management of its Calcutta business under a mercantile Secretary would be worth more than the extension of its circulation in the interior under an official Secretary.

the Bank's notes over such an extended area, he outlines a system of circles with notes payable at circle offices and the Bank head-quarters which is not unlike the scheme actually adopted by the Government in 1862. The time, however, was not ripe for this project. Only a month before the Directors had been called on to consider a scheme * for a "Great Banking Establishment for British India," and had replied that while some of them thought it "very possible" to establish a branch at Bombay, others inclined to think that the object might be even better accomplished by the Government chartering an independent Bank at that town. The question came under the consideration of the Proprietors six months later, and they disposed of it by passing (apparently almost unanimously) a resolution affirming that "it is not at present desirable to extend the operations of the Bank either by way of branches or agencies or in any manner to place the assets or responsibility of the Bank beyond the immediate control of the Calcutta Directors."

The Proprietors, at the same meeting, were asked to concur in certain modifications of the existing Charter which had been agreed upon between the Directors and the Government after negotiations which originated in 1833 in the circumstances already explained, and had lasted till 1837.

The alterations proposed were sweeping, and the Government of India had themselves taken the lead in suggesting them. They considered the limit on advances to be "absurd" and the draft Bill omitted it. They held it to be "indispensable" to modify the rule requiring the maintenance of a cash reserve of one-fourth, and the draft Bill placed the limit at one-eighth—a proportion which the Directors had represented as exceeding "the proportion assumed by the most solid and best conducted Banking establishments in Great Britain as the rule of conduct." The Government of India had of their own accord cut out of the Bill the clause giving a power of making bye-laws which they observed "seems never to have been used and is not likely to be

* This interesting suggestion is more fully noticed in Chapter VIII.

required," and they had themselves added a power to deal in exchange, with the following explanation :—

" Preparatory to the establishment of Branch Banks and indeed in order to enable the Banks to employ agents to facilitate remittance transactions, His Lordship in Council has added to the descriptions of business to which the Bank has hitherto been restricted the purchase and sale of bills of exchange and of bullion which are a kind of business he understands to be allowed to the Bank of England."

It must not be supposed that in suggesting the last-mentioned addition the Government of India overlooked the possibility of the Bank embarking on exchange operations with England. The subject had only a month previously been under the consideration of the Directors, and the Government were no doubt aware of the fact.

On most of these points, however, a very different view was taken by the ultimate authorities—the Proprietors of the Bank and the Court of Directors of the East India Company. The Proprietors, as already stated, declared against a policy of rapid extension by means of branches, though they did not object to power to open them being taken in the Bill. After the words " buying and selling Bills of Exchange," they made the significant addition " payable in India," thus voluntarily imposing on themselves one of the most important and permanent restrictions under which the Bank has worked. The cash reserve of one-fourth was restored, apparently by the Court of Directors in England, and the limit on advances was re-imposed, being raised, however, from 1 lakh to 3 lakhs. The prohibition against the grant of advances on bank shares had also been omitted, but was ultimately maintained. In the end, therefore, the new Charter Act, which was finally passed in 1839, did not differ very materially from its predecessors.

The capital of the Bank at the end of this period apparently stood at a little over a crore. The Court of Directors in 1835 had insisted on compliance with their orders of 1829 requiring the increase of the Bank's capital from 50 to 70 lakhs of *sicca* rupees. Shortly after this the " Company's rupee " (*i.e.*, the present rupee) replaced the *sicca* rupee in the East India Company's

coinage, and was adopted in the Bank's accounts from the 1st January 1836. The capital was, therefore, fixed by Act XIX of 1836 at 75 lakhs—the nearest round number under the new coinage which gave the full amount of increase required by the Government. Though the Proprietors had at one time objected to this increase of capital, they themselves resolved on a further increase of 37½ lakhs in 1838, and measures were taken the same year to give effect to this proposal under powers conferred by Act XXIV of 1838. The reasons for this sudden change of policy are not very clear, but the object seems to have been to bring the Bank's capital up to the level of that of the Union Bank which at that time was threatening the supremacy of the Presidency Bank. Apparently the additional amount called for in 1838 was never fully subscribed, for the Bank's capital stood at only 107 lakhs more than 20 years later.

But few details can be given of the history of the next twenty years. The Charter of 1839 remained in force till 1862, being only slightly modified by Acts XXI of 1851 and XXVII of 1855, both of which are noticed * elsewhere. By the creation of the Banks of Bombay and Madras in 1840 and 1843 the Bengal Bank lost the chance of extending its operations into other Presidencies; and though power had been taken in 1839 to open branches elsewhere, the power was not exercised. The Bank would seem to have accepted the limitations which the Charter re-imposed, and to have continued its steady but strictly local development on the old lines.

Before leaving this period one episode may be noticed which is of great interest as showing how far the restrictive provisions of these earlier Charters fulfilled the purpose for which they had been framed. In 1857 the occurrence of the mutiny threw an exceptional strain upon the resources of the Bank. Distrust of the security of the Bank and even of the Government itself led to the presentation by natives of large numbers of notes for encashment. The military operations of the Government must also have caused a drain of specie from Calcutta, and the Bank had also to face a largely increased demand for accommodation on the part

of the commercial community. To meet the demand for cash by tenderers of notes and comply with the rule that the cash balance should not fall below one-fourth of the outstanding liabilities, the Bank had to restrict accommodation; but there was acute disagreement between the elective Directors and the Government Directors as to the best method of doing this. The latter favoured the correct policy of raising the rates of discount to any amount which experience might show to be sufficient to restrict the demands on the Bank to the desired extent. The elective Directors, being in a majority of two to one, were able to insist on the retention of the usual discount rate, and granted accommodation to selected individuals only, while refusing to make advances even on Government Paper to other applicants who might have been willing to pay a far higher rate. The Government Directors recorded a protest against the action of the majority, and drew the attention of the Government to the state of affairs. The Government then called on the majority for an explanation of their reasons for pursuing the course above described, This explanation the Directors refused to give, and it was decided that it would not be wise to press for it. Meanwhile the Bank by following this course had got "out of rule," i.e., their cash balance had fallen below the prescribed minimum. On the 21st July 1857 they had a cash balance of 127 lakhs to meet liabilities of 242 lakhs, i.e., the cash balance exceeded half the liabilities. The amount of loans on the security of Government Paper was then 157 lakhs and the note circulation about 160 lakhs. By the 2nd October the cash balance stood at 56 lakhs or just over one-fourth of the liabilities which amounted to 222 lakhs; the loans on the security of Government Paper had reached 203 lakhs; and the note circulation had fallen to about 115 lakhs. Shortly after, the cash balance fell to an amount which was less than a quarter of the liabilities by 5 lakhs. The Government Directors then proposed to raise the rate of discount on outstanding loans, and to refuse all fresh accommodation entirely. The elective Directors again overruled them, and the Government thereupon privately announced their intention of seeking an injunction restraining the Directors of the Bank from granting further accommodation. Fortunately the

Government were not compelled to carry this dangerous threat into execution. The Directors submitted. They formally protested, however, against the course pursued by the Government, alleging that the Bank had on many previous occasions been "out of rule," but no notice had been taken by the Government Directors or by the Government; they also stated their belief that "nothing short of a suspension of cash payments could have prevented the Bank from appearing out of rule for a time." The Government replied that the rule must be rigidly observed in the future; and the Court of Directors, to whom the correspondence was forwarded, supported the action of the Government Directors and gave instructions that the latter should always keep in communication with the Government regarding the affairs of the Bank.

The incident is instructive. In 1832 the Government Directors had joined in setting aside the stringent rules which they were bound on oath to see enforced, and had not even informed the Government of what was going on. The system of control had therefore failed. But in 1857 the Government Directors did their duty, and gave the Government timely notice of the impending infringement of the terms of the Charter. The Government, when they got this information, were almost helpless. They were unable to intervene effectively till perhaps the most important safeguard provided in the Bank's constitution had been set aside, and then only by using a menace which, if enforced, would probably have caused the ruin of the Bank. So much for the system of Government control. As regards the system of mechanical checks, the minimum cash reserve, and so on, the experience on both occasions was that the Directors set the restrictions aside in times of difficulty because they could not help themselves, and set them aside at other times because their doing so involved no possible risk. Three years later, in 1860, the Government themselves illegally sanctioned the issue of notes in excess of the statutory limit of two crores.

The legislation of 1862-63 removed almost all the restrictions which are so characteristic of this earlier period. But, though it had sometimes been found impossible or inconvenient to enforce them, they had on the whole been effective and salutary. It was largely owing to the possession

of a conservative constitution, which the Government never allowed to be deliberately and entirely set aside, that the Bank passed safely through the critical times in which so many* Indian Banks succumbed; and the limitations imposed by that constitution did not prevent it from attaining a considerable development, and rendering important service to Government and to commerce, while paying throughout a respectable dividend to its proprietors. It must be remembered, too, that these limitations were imposed in the interests and at the wish of the shareholders generally. The Government took shares as a guarantee to the commercial community that they would maintain a close supervision over the management of the Bank, and without that guarantee the rest of the capital would not have been subscribed. When in 1837 the Government were inclined to sanction a more enterprising policy, it was the proprietors as well as the Court of Directors in England who insisted on caution. Finally, when in 1876 the Secretary of State directed the Government of India to surrender their shares and cease to appoint directors, his instructions were opposed by the proprietors themselves as strongly as by the Government, and the proprietors asked to be allowed to *elect* Government officers to their Board of Direction after the system of appointing official directors had been discontinued. The Government from the first shared the wish of the private proprietors to make the Presidency Banks great and flourishing institutions. If they imposed some conditions which now appear unduly restrictive, they did so because it was believed that these conditions were indispensable to safety, and not through any jealousy of the increasing influence of the Banks, or through any desire to specially protect their own interests without regard to the general welfare of the Banks or of the public.

* The Union Bank is an example of this. In 1840 it had a capital of one crore, and though its note issue was not recognized by the Government, it competed not unsuccessfully with the Bank of Bengal in other respects. In 1848 it failed having lost its capital in transactions remarkably similar to those in which the Bank of Bombay engaged in 1862—1867. It also lost money in Exchange operations. The deed of partnership of this bank contained many of the safeguards found in the Bank of Bengal's charters, but they were evaded. For example, there was a time-limit (four months) on advances which was evaded by a promise being made at the time an advance was granted that it would be renewed.

CHAPTER II.

* THE BANK OF BENGAL—SECOND PERIOD (1862—1876) AND
THIRD PERIOD (1876—1899).

As Banks of issue the Presidency Banks had been subject to a two-fold restraint. They were directly controlled by the Government and the scope of their business was restricted by their charters. In 1862 they were deprived of the management of a note circulation, and given in its stead the use of the Government balances and the management of the Treasury work at the Presidency towns and at the branches. Partly as compensation for this change, partly because the old restrictions had been sometimes ineffective, and partly, perhaps, because the new duties were supposed to involve a less onerous responsibility than the old, it was decided to give the Banks for the future a wider discretion in the conduct of their business. The subsequent history of the Banks is the history of two experiments in this direction. In 1862 the old statutory limitations were very greatly relaxed, but the Government's powers of control remained unchanged. In 1876 nearly all the most important limitations of the earlier period were re-imposed, but the Government desisted from direct interference in the management. By ceasing to appoint official directors and by disposing of their shares they divested themselves of both the right and the obligation to intervene.

The two later periods of the Bank's history may also be distinguished in another way.

It has been shown how in the years from 1809 to 1839 the constitution of the Bengal Bank as a Bank of issue was gradually modified till it took its final shape in the Charter of 1839. This period of adaptation was followed by a long term of development on fixed lines. When in 1862 the Banks became bankers for the Government, the process of adaptation began again. In 1876

* This Chapter includes a summary of Chapters IV, VI, VII and VIII, and is not strictly confined to the Bank of Bengal.

it was practically completed and another long period ensued during which there was little that was new in the way of discussion, experiment, or actual change. The two really important issues of the twenty-three years since 1876 have been the question of borrowing in England and the question of lending from the Reserve Treasuries. Except for these questions there is little to notice in the history of the Banks since 1876. But between 1862 and 1876 almost every question of importance to the Banks was discussed, and many were so far settled that they are only now being revived under a new set of conditions. The following are some of the subjects then dealt with:—

- (1) The restrictions upon the banking business transacted by the Banks and in particular the question of dealing in foreign exchanges.
- (2) The classes of Government business transacted by the Banks and especially their connection with the Paper Currency; and their remuneration for the transaction of such business.
- (3) The employment by the Banks of the Government balances.
- (4) The grant of advances to the Banks from the Currency Reserve.
- (5) The question of the sufficiency of the Banks' capital.
- (6) The amalgamation of the Banks.
- (7) The establishment of Branches.
- (8) The question whether Government business in the interior should be made over to local Banks or to Branches of the Presidency Banks.
- (9) The question of competition between the Banks.
- (10) The question of Government control.

The first six of these questions are examined in the succeeding chapters and need only be briefly referred to here. The question of permitting the Banks to deal in foreign exchanges was settled almost without being raised. It took four years of constant protest on the part of the Banks and the Government of India to induce the Secretary of State to allow the Banks to remit

the dividends of their constituents in England by their own bills. His first objection was raised in September 1862 and he only reluctantly gave way in December 1866. His opposition on this point showed that it would be useless to raise the larger issue. The question of modifying the restrictions on business generally as defined by the Charter Acts of 1862-63 might never have arisen as far as the Bank of Bengal was concerned. But the failure of the Bank of Bombay in 1868 demonstrated the necessity of a stricter charter and the old limitations were re-imposed without serious protest in 1876. They have been accepted ever since, practically the only proposals for larger powers till the year 1899 being the suggestion that the Banks should be allowed to lend on the securities of the Ceylon Government and on the securities of Assisted Branch Railways. Both suggestions were negatived. It may be added here, to complete this part of the subject, that in 1879 the Banks were given power to borrow in India but were refused power to borrow in England.

The relations between the Government and the Banks in the matter of Government business were first settled in 1862 and were revised in 1866, 1876, 1886, and 1898. With one exception there has been little difficulty in settling the classes of business to be transacted by the Banks, or the remuneration to be granted to them. The exception referred to is the paper currency business which the agreements of 1862 authorized the Banks to transact as agents for Government. This class of business was withdrawn from the Banks under the orders of the Secretary of State in 1866, the agreements being revised in that year on that account. The revision of 1876 was rendered necessary by the passing of a new Charter Act (the Presidency Banks Act of 1876). Only minor changes were introduced in the two later revisions.

The Presidency Banks were first permitted to have the use of the Government Balances in 1862, and the terms on which they should be allowed to use them have been the subject of constant discussion almost ever since. It would take too long to describe here the various stages through which the question has passed. It will be sufficient to state that till 1876 the Banks enjoyed the use, in some form, of the whole of the Government balances at the

Presidency towns, and at their Branches, free of interest. In 1876 the amounts left with the Banks were limited by the establishment of Reserve Treasuries, and the question has since taken another form, namely, that of settling the terms on which the Banks should be granted loans from the Reserve Treasuries. Till 1893 such loans seem to have been granted with comparative freedom, though the Government have refused both before and since that year to commit themselves to a definite engagement to make such loans when asked to do so. Since 1893 there has been at times a danger of the loans being used to enable the Exchange Banks to oppose the Secretary of State in the sale of Council Bills, and they have been less freely given. The most recent declaration of policy, however, shows a tendency to greater liberality in this direction.

The next three questions were practically raised and disposed of by one or two isolated incidents and led to no prolonged discussion. In 1865 the Government agreed to advance the Bank of Bombay a crore-and-a-half from the currency reserve to prevent the Bank from suspending payment, but the mere assurance proved sufficient and the advance was not made. The Banks have not again asked for this relief under similar circumstances, though it has recently been proposed that they should be allowed to draw on the currency reserve as a means of expanding their resources during periods of monetary stringency.

In 1864 the Bank of Bengal doubled its capital at the instance of the Government, but it has not again been increased. The Bank of Bombay quadrupled its capital in the same year of its own accord, but had lost almost the whole by 1867 and the present Bank has a capital of only half the amount possessed by the old Bank. The Madras Bank increased its capital in 1863 and again by a small amount in 1897. The following are the figures (in lakhs of Rs.) :—

	1863.	1864.	1899.
Bank of Bengal	110	220	200
„ „ Madras	30	56	*60
„ „ Bombay	52	209	100

* The increase in 1899 was 10 lakhs, the capital having been reduced to 50 lakhs in 1876. See first paragraph on page 30.

The amalgamation of the three Banks into one Bank controlled from Calcutta was proposed in 1867 in anticipation of the failure of the Bank of Bombay. The proposal, however, fell through owing to opposition at Bombay.

The foregoing questions (Nos. 1 to 6 of the list) are still of considerable practical interest, and a fuller account of them will be found in Chapters IV, VI, VII and VIII. The four remaining subjects on the list can be finally dealt with here.

The first of these subjects is the question of establishing Branches of the Presidency Banks. The materials available do not permit of the presentment of the later history of the Banks from the point of view which would be of most interest to a Banker or the public. The records of the Government of India describe the discussions which took place between the Government and the Banks and between the Government and the Secretary of State, and give no prominence to changes and developments on which all were agreed from the first, or which did not require the executive or legislative sanction of the Government. Undoubtedly the chief of these developments was the institution of the Branch system. The Bank of Bengal had no Branches till the time the proposal to transfer Government business to the Banks was made in 1861-62. The offer of Government business in the interior induced it to open Branches at several important centres, and it is well to call attention to the fact that this extension of its business is primarily due to its connection with the Government. It now acts as the Government Banker at fourteen* different Branches, and, while the private Banking business transacted at these Branches is valuable in itself, the connection so obtained increases the operations of the Head Office.

The system has not, however, been extended in recent years. Though no less than 18 Branches (including the Bombay Agency) had been established by 1868, the total number at present is only 17 (three of which do not transact Government business).

* Similarly, Government business is transacted by the Bank of Madras at 10 Branches and by the Bank of Bombay at 7 Branches.

When the Branch system was under consideration in 1861 and 1862 there were a number of Banks already established in the interior, and one of these, the Agra and United Service Bank, offered to take over the Government business at Agra, Allahabad, Delhi, Lucknow and Lahore. The Government were of opinion that an existing Bank should be given the preference even though the Presidency Banks were willing to open a branch at the same place. The Secretary of State, however, in 1863 refused to allow Government business to be made over to other Banks. This decision, which was applied in the case of the Agra and United Service Bank and has ever since been acted on, gives an important but not undue advantage to the Presidency Banks. It enables them to choose their own time and place for opening their Branches; against the advantage which a private Bank possesses by virtue of its freedom from the restrictions imposed by the Presidency Banks Act, or may hope to gain by priority of occupation, it has to set the fact that it may at any time have to compete with a rival institution enjoying the use of the local treasury balances and the prestige of Government recognition.

The Presidency Banks were thus given a monopoly as against other Banks. The question also arose whether they should be allowed to compete with one another. Towards the end of 1867 the failure of the Bank of Bombay was known to be imminent and it had become certain that the proposal for the amalgamation of the Banks could not be carried through. The Bank of Bengal therefore decided to withdraw its Bombay business from the Bombay Bank which had previously acted as its agent, and with a view to managing the business itself, the Bank telegraphed to the Government of India as follows on 20th October 1867 :—

“ In prospect of early liquidation of Bank of Bombay, the Directors propose to send an agent to Bombay to collect this Bank's outstandings there ; do you approve ? ”

The Government of India replied as follows the next day :—

“ The Government of India cannot object to the despatch of an agent whenever the Directors may think it necessary.”

The agent was immediately despatched with a letter of instructions which was seen not more than a few weeks after it was sent by the Financial Secretary and apparently by the Finance Minister ; and less than four months after the establishment of the agency the Bank of Bengal informed the Government that it had purchased premises in Bombay at a cost of two lakhs of rupees.

The letter of instructions above referred to included the following direction :—

“ As it is not the intention of the Directors to establish a regular Branch for the transaction of every description of business, you will understand that your duties will be strictly confined to realizing the Bank's assets, collecting bills sent from time to time, disposing of the proceeds as you may be instructed, honouring drafts drawn by the head office and branches, and generally conducting the business heretofore transacted for this Bank by the Bank of Bombay. The receipt of deposits is thus carefully excluded.”

It was subsequently asserted that these orders, which, at first sight, appear to restrict the duties of the agent within very narrow limits, really permitted him to transact all classes of business except the receipt of deposits. Probably the more correct view was that taken by the Government of India who held that it included “ all the operations of banking permitted to the Bank of Bengal except receiving deposits, discounting bills and granting loans.”

Mr. Gay, who subsequently became Comptroller General, was appointed at the end of 1868 to examine and report whether the Bank's agent had exceeded these instructions. He reported that he had not. The Agent had refrained not only from receiving deposits, but also from discounting local bills and granting loans.

The Agent had in fact transacted for his Bank only those classes of business which the Bank of Bombay might have transacted as Agent, but, as Mr. Gay pointed out :—

“ The business obtained (in Bombay) by the (Bengal) Bank has been much extended in degree by the establishment of an independent agency, while certain kinds, such as purchase of bills in towns where branches exist, purchase of Bank Post Bills and Currency notes at a discount, etc., though in theory

they might be taken by one Bank simply as Agent for another, yet in practice would be taken by the Agent Bank on its own behalf, and to its own, at least partial, profit."

The increase of business so obtained by the Bank of Bengal may be judged by the following figures which the Bank supplied to the Government of India in 1873. The first line of figures shows the total amounts (in crores of rupees) of the transactions of the agency during the last five years in which the Bank of Bombay was agent, and the second the corresponding totals during the first five years in which the Bank had an independent agency :—

	Tern over in cash account.	Remittances to agency.	Withdrawals from agency.
1863—67	10	5	5
1868—72	56	29	23

The establishment of the agency at Bombay gave rise to much controversy between the Banks of Bombay and Bengal and to differences of opinion in the Supreme Council. Some of the Members considered that the Government had intentionally and formally ratified the establishment of the agency as a permanent institution, and that it would be grossly oppressive as well as impolitic to require its removal. Others held that under the pretext of sending an agent for a purely temporary emergency the Bank had virtually concealed a scheme for forming a regular Branch at Bombay.

To the old Bank of Bombay which had only a few months more to run the establishment of the agency did not much matter. But with the new Bank which followed it the case was different. It suffered in prestige by the close neighbourhood of a more powerful Bank, and its position at the first was so precarious that it could ill afford any loss of prestige; it suffered also some loss of business; and above all probably, it was apprehensive that unless it made a vigorous outcry the restrictions on the Agent's operations would speedily be removed. The controversy was prolonged. The papers written on the subject during the first 19 months after the establishment of the agency

in 1867 fill 130 pages of print, and the question was not finally settled till 1876. The Secretary of State was throughout on the side of the Bank of Bombay. He repeatedly gave instructions for the removal of the agency, and even recommended the Government of India to resort to special legislation since the Bank refused to retire without compulsion and could not legally be ejected. Ultimately the matter was left over till the expiry of the agreements which had been entered upon in 1866. When these at length came under revision, the Secretary of State proposed that the renewal of the Bank of Bengal's agreement should be conditional on the withdrawal of the Bombay Agency, but it was obviously impossible to require that Bank to entrust its legitimate business in Bombay to a bitterly hostile institution. Matters were therefore left as they were, and the Act of 1876 formally recognizes the opening of a branch of a Presidency Bank in the other Presidency towns, but imposes restrictions on the classes of business to be transacted by which direct competition is as far as possible prevented.

The terms of the section dealing with the point are as follows :—

“No agency of the Bank now or hereafter established in Bombay, Calcutta or Madras shall advance or lend money or open cash credits on securities or receive deposits and keep cash accounts or discount bills of exchange drawn and payable in the Presidency in which it is so established.

“Or shall act as agent on commission or transact any business except as agent of its principal Bank or any of its branches or other agencies.”

The other Banks have not thought it worthwhile to ask permission to open agencies in Calcutta, but the Bank of Bengal's agency in Bombay still remains.

The controversy is something more than an interesting episode in the history of the Banks. The discussions regarding the Bombay Agency and the similar attempts made by the two Banks to encroach on one another's territory in Hyderabad and Berar definitely settled the question of mutual competition between the Presidency Banks. It was obvious that these Banks, all of which numbered the Government among their share-

holders, directors, and depositors, could not be allowed to use the prestige and capital so obtained to destroy one another. Nevertheless, the action of the Bengal Bank found some support, and it is possible that had the question first arisen after the Government connection with the Banks as shareholders and directors had ceased, the policy of unrestricted competition would have been adopted. It was indeed found so difficult to adjust the contending claims of the Banks elsewhere, in view of the position created by the existence of the agency at Bombay, that both Lord Mayo and Sir Richard Temple were inclined definitely to recommend the adoption of "free trade" all round. Thus the Viceroy wrote:—

"We cannot enforce monopoly and if we move at all we can only take the other course and advise competition I think on the whole free trade between the three Banks is almost the only course open to us, and I do not see that it would be injurious to the interests of the public. If it led to amalgamation, it is probable that the public would gain."

But this suggestion was opposed by a Member from the Bombay Presidency who saw in the extension of competition the inevitable "annihilation of the Bombay Bank."

The last subject in the list given in an earlier part of this chapter is the question of Government control, and in particular of control through official directors. This subject gave rise to almost as much writing as the question of the agency at Bombay and hardly yields to that question in interest. The system of Government representation on the direction of the Banks admittedly failed in the case of the Bank of Bombay and for this reason was condemned by *Sir C. Jackson, the President of the Commission which enquired into the failure of the Bank of Bombay. But in that case "the system of commercial directors failed still more signally" as was pointed out by a member of the Commission. The system of official directors had worked well on the whole, especially in the case of the Bank of Bengal. The official directors on the Board of that Bank were further removed from local influ-

* Sir C. Jackson is mentioned in several places in this Memorandum. He had been a Master in Chancery and a Judge of the High Courts of Calcutta and Bombay, and had previously presided over the Committee of Investigation into the affairs of the London, Chatham and Dover Railway.

ences, such as those which carried away the Bombay Directors, and had the advantage of being in intimate relations with the Supreme Government. The system enabled the Bank to obtain the services of the highest financial advisers* of the Government and brought the Government into close touch with commercial feeling and interests. The Government Directors were the official representatives of caution, and it was admitted that the best Secretaries of the Bank were often indebted to the Government Directors for the support which enabled them to successfully resist a policy which appeared to be dangerous. But though cautious, they do not appear to have been timid and obstructive. They must have performed with some tact the rather delicate duty of keeping the Government informed of the affairs of the Bank, for there is no trace in the papers of any friction between them and the elective directors. The emphatic opinion expressed by Mr. Dickson, the Secretary and Treasurer of the Bank of Bengal, before Sir C. Jackson's Commission may be quoted :—

“Not only,” Mr. Dickson said, “do I see no objection to the present system of Government Directors, but I hold a very strong opinion that the constitution of the Board composed partly of Government and more largely of commercial Directors is eminently satisfactory and desirable. I have never known any serious difference of opinion on questions submitted for their instructions, nor have I observed the slightest unpleasantness arising out of their decisions. Adherence to business principles, the upholding of public credit, and the safety of the Bank have been invariable marked characteristics of their discussions and decisions.”

However, the Government, or rather the Secretary of State, preferred the abandonment of the power of effective control to the possibility of again having to share in the responsibility for such a disaster as that which befell the Bank of Bombay. In the Act of 1876 the sections of the earlier Acts relating to the Government Directors were not reproduced, and the power to call for information and papers was only conditionally retained, the wording of the Act on this point being as follows :—

“The Governor General in Council and the Local Government shall (so

* The official Directors included the Financial Secretary and the Comptroller General.

long as any such arrangement with the Government as aforesaid remains in force) at all times be entitled to require of the Directors any information touching the affairs of the Bank, and the production of any document of the Bank."

The object of the Government in alluding to the improbable contingency of their ceasing to employ the Presidency Banks was not so much to provide for that possibility beforehand as to indicate that they took power to enquire into the affairs of the Banks solely for their own protection. To use Sir C. Jackson's words, they aimed merely at "Government control, sufficient for its own security, but without responsibility or guarantee on the part of Government for the good management or stability of the Bank."

The Government at the same time sold their shares in the Banks. Even in 1807 the authorities in England had objected to the anomaly of the Government becoming partners with private capitalists in a commercial undertaking, and had only agreed because the Bank of Bengal could not otherwise have been started. For the same reason objection was taken, and waived, when it was proposed in 1867 that the Government should take shares in the new Bank of Bombay. But when this Bank had been successfully floated and could safely be left to its own resources, the Government of India could no longer oppose the Secretary of State's wish that the shares should be sold. After 1876 the relations between the Banks and the Government were merely those of agent and principal (as regards Government business), and of banker and depositor (as regards the Government balances).

We have now glanced at the questions which have been most prominent in the later history of the Banks. The chapter may be concluded with a statement of figures which will give some idea of the development of the Bank of Bengal during the period it has acted as Banker for the Government. The year 1861 was, it will be remembered, the last year during which the Bank enjoyed

the right of issue. The year 1898 is the last year under the present system for which complete figures are available:—

	1861.	1898.
	Lakhs.	Lakhs.
	₹	₹
Capital	107	200
Reserve	2	91
Note circulation	173	...
Government balance	178
Other Deposits	124	484
TOTAL	406	951
Discounts	15	158
Loans, etc.	151	409
Investments	28	114
Cash Balance	215	260
TOTAL	405	936
Net profits	₹10 lakhs.	₹29 lakhs.
Percentage of net profits to Capital	9½ per cent.	14½ per cent.
Dividend actually paid	9½ „	10 „

The increase of the Bank's reserve fund is a striking feature of the above figures. In 1861 the reserve fund was 2 lakhs only as stated above. In 1862 it was increased to 16 lakhs and by 1877, when the Bank's capital was two crores, it still amounted to only 20 lakhs. From that year additions have been regularly made from profits till the reserve now amounts to 98½ lakhs or practically half the Bank's capital.

Another point which may be noticed is the remarkably strong cash balance which the Bank has always held. Between 1856 and 1861 the average proportion of cash to liabilities varied from 43 per cent to 72 per cent. In 1865 and 1867 it rose to 87 per cent though the Government deposits were low in those years, and the average never fell below 50 per cent till 1882. The lowest* ever reached is about 38 per cent, the average in 1896 and 1898.

* *I.e.*, the lowest annual average, not the lowest proportion on any single day.

The Government deposits with the Bank have varied greatly under circumstances which are explained in Chapter VII. In 1862 they averaged R4½ crores and in 1863 R3½ crores. From 1864 to 1870 the annual average varied between R1 crore and R2 crores. It rose again to R4½ crores in 1871 and did not fall below R3 crores till 1877. The high figure of R3 crores has never again been reached and for the last eight years the deposits have averaged less than R2 crores. The figures given include deposits at branches as well as at the head office.

The variations in the private deposits have been almost equally marked. The amount of R2½ crores was reached in 1865 and was generally maintained till 1884. In some exceptional years a higher figure was reached. Thus in 1867 the average was 372 lakhs, in 1868 469 lakhs and in 1869, 1870, 1880 and 1881 the average exceeded 3 crores. From 1885 to 1890 the average was again in excess of 3 crores and in 1891 rose to R666 lakhs, the highest figure ever reached, the bank rate falling in a part of that year to 2 per cent. Since 1891 the annual average has varied between R4½ and R5½ crores.

The highest dividend for a whole year since 1855 was 15 per cent in 1864, the lowest 6½ per cent in 1869. In the last few years the Bank has regularly paid 10 per cent after setting aside large sums to reserve. The best test of the actual profits made is the percentage of net profits to capital *plus reserve*. This percentage has varied as follows:—

	Average percentage.
1856—1861 (Capital 107 lakhs; reserve 2 to 4 lakhs) .	12
1862—1863 (Capital 110 lakhs; reserve 13 to 16 lakhs) .	12·8
1864—1875 (Capital 220 lakhs; reserve 15 to 19 lakhs) .	8·8
1876—1892 (Capital 200 lakhs; reserve 16 to 58 lakhs) .	9·7
1893—1898 (Capital 200 lakhs; reserve 56 to 91 lakhs) .	10·6

CHAPTER III.

THE BANKS OF MADRAS AND BOMBAY.

It is not necessary for the purpose of elucidating the relations between the Government and the Presidency Banks to attempt anything like a complete history of the Banks of Madras and Bombay. Indeed the materials for such a narrative are not at hand. We know little of what happened to them before 1862, and the dealings of the three Banks with the Government after that date could not conveniently be separately described. The agreements between the Government and the Banks were all revised at or almost at the same time and on the same lines, and their charters were also revised together by the Presidency Banks Act of 1876. The single special event which need be noticed at any length is the failure of the Bank of Bombay. That event had an important effect on the history of all the three Banks, and some of its results are examined in other chapters. This chapter will include a brief narrative of the incidents which led up to it.

The Bank of Madras was incorporated under Act IX of 1843 with a capital of 30 lakhs, 2 lakhs of which had been subscribed by the Government. The new Bank was given a right of issue, the circulation being limited to one crore. In practically all other respects its charter resembled that given to the Bank of Bengal by Act VI of 1839. On the formation of the Bank of Madras the "Government Bank of Madras" was abolished. The latter Bank had been managed, very unsuccessfully, by Government officials alone, and the new Bank did not at first fare much better, for "within a period of two years and a half from its establishment, it was twice placed in circumstances of serious embarrassment." On one of these occasions its cash balance fell to four lakhs while its liabilities were 36 lakhs, owing partly to "improper advances made for speculative purposes in the Calcutta market." On the second occasion the Bank had to ask the Government not to present for payment the notes of the Bank then held in the Government Treasury, and this request

being refused "they applied to the Government to discount their own acceptances held by the Bank falling due within 30 days. The Government with a view of averting the serious public evils which would result from the total exhaustion of the coffers of the Bank complied with this request," but "to mark their disapprobation" charged for the accommodation at the rate of 8 per cent per annum. After the withdrawal of the right of issue in 1862, the Bank of Madras was given a new charter (Madras Act V* of 1862) similar to that given to the Bank of Bengal by Act IV of 1862. Power was given to the Directors to increase the capital to a maximum of 60 lakhs, and the capital was raised to 56 lakhs in 1863; it subsequently fell to 50 lakhs when the Government cancelled their shares in 1876, and remained at that figure till 1897 when it was raised to 60 lakhs.

The Bank of Bombay was incorporated by Act III of 1840 with a capital of 50 lakhs, of which the Government had subscribed three. Its note circulation was limited to two crores. The charter was similar to that granted to the Bank of Bengal in the previous year by Act VI of 1839. The revision of both these charters became necessary when the right of issue was withdrawn in 1862, and both Banks were again given generally † similar charters (Act IV of 1862 for the Bank of Bengal and Act X of 1863 for the Bank of Bombay).

The capital was stated in the Act of 1863 at ₹52,25,000, and the Act gave the proprietors power to increase it up to 210 lakhs. Advantage was at once taken of the power thus conferred. The capital was increased to 104½ lakhs in the same year and again to 209 lakhs in 1864. In January 1867 it was reduced to 104½ lakhs, the other half of the capital having been lost. The Bank went into liquidation in January 1868, and, according to the estimate made by the liquidator at the end of that year, the loss of capital amounted to 189 lakhs. Its liabilities were paid up in full.

* This Act was repealed by Madras Act VI of 1866 which permitted the Bank to engage in business with Ceylon and made other minor changes which do not require notice.

† The Bombay Bank Act, however, permitted advances on shares which the other Act did not. See pages 41 and 42.

A new Bank of Bombay was formed the same year, apparently with a capital of 100 lakhs of which 50 lakhs was paid up at once and the rest in 1874. The paid up capital of 100 lakhs has not since been increased. The Government took shares in the reconstructed Bank, as it was believed that without such assistance the Bank could not be floated. The Government ceased to be a shareholder in 1878, but the Government shares were placed on the market instead of being bought in and cancelled as in the case of the other two Banks. There was thus no reduction of capital.

A Commission of which Sir C. Jackson was President was appointed to inquire into the failure of the Bank of Bombay. The report of the Commission which was published in 1869 ascribed the failure to the following causes :—

- (a) The Charter Act "which removed many restrictions contained in the former Act and permitted the Bank to transact business of an unsafe character."
- (b) "The abuse of the powers" given by the Act "by weak and unprincipled Secretaries."
- (c) The negligence and incapacity of the Directors.
- (d) "The very exceptional nature of the times."

The extent to which the first of these causes contributed to the failure is noticed in Chapter IV. Sir C. Jackson summed up his views on this point in the dictum that "the great lesson the failure taught was that Banks should not lend money on promissory notes in a single name or on joint promissory notes when all the parties were borrowers and not any of them sureties for the others."

It is unnecessary to discuss the next two causes mentioned. The Secretaries of the Bank were "thoroughly unscrupulous and mischievous," the Commercial Directors were "almost all young and inexperienced," and the Government Directors "neglected their duty."

The exceptional nature of the times is well known. The following extract from a speech made by one of the Directors

at a meeting of the proprietors in 1867 is one of many descriptions of the mania for speculation which overtook Bombay :—

“In the first place these losses are not the result of the last few months, but of transactions extending back as far as 1864, and to get at the causes we must look back even further than that—to the civil war in America, which cut off the chief source of supply from the European Cotton Trade, and led to a rise in price, which gave Bombay merchants and cotton dealers the opportunity of realizing profits previously unheard of. These profits as they returned to Bombay produced a plethora of wealth far beyond the requirements of *bona fide* trade for which some extraordinary means of investment were absolutely necessary; hence the introduction of endless schemes and joint stock companies, the shares in which invariably rose to a price which naturally led to the formation of more, and the business of too many of which was merely to give greater facilities for extending credit and encouraging speculation. Then came that most unfortunate step, the doubling of the Bank's capital, giving it another million sterling to find employment for, at a time when credit was inflated to a most dangerous extent and when every sound principle of business finance was deranged. The panic which was sure to follow upon a cessation of hostilities in America brought about a re-action in prices, corresponding to the high rates which had previously ruled. It was then found that our capitalists almost without exception had the greater part of their wealth locked up in property the value of which was rapidly vanishing. Any desire to realize only hastened the downward course, and deterred many from the attempt.”

The report of the Commission says :—

“Almost every one in Bombay appears to have become wild with the spirit of speculation. Companies were started for every imaginable purpose, banks and financial associations, land reclamation, trading, cotton cleaning, pressing and spinning companies, coffee companies, shipping and steamer companies, hotel companies, livery stables and veterinary companies, and companies for making bricks and tiles. The shares of most of these companies were sold at high premia as soon as they were brought into the market.”

The report gives the case of the Back Bay shares as an example of this. The Government of Bombay had intended to take shares in this Company, but the Government of India refused their sanction, and the shares reserved for the Local Government were sold by auction at a profit of over 500 per cent on the amount paid up on them.

It is impossible, in a brief abstract of the Commission's report, to do justice to their graphic description of the mismanagement and unscrupulousness by which the Bank was ruined. But it may be of interest to present a few of the leading details. The report distinguishes five stages in the interval between the passing of the Act of 1863 and the failure of the Bank in 1868:—

- (1) *August 1863 to June 1864.*—During this period the Directors passed a Resolution prohibiting the Secretary from making advances on shares without reference to the Board. But, though advances were not at first openly made on shares, the Secretary opened cash credits and discounted bills on promissory notes signed only by the borrower, and concealed the fact from the Directors. He also ceased to maintain the discount list showing the credit of each merchant. In this period the capital was raised to 2 crores.
- (2) *June 1864 to April 1865.*—This was the period of speculation. The Directors formally sanctioned the grant of loans on the security of one name and embarked on "the most reckless system of advances." One Director, Premchand Roychand, obtained loans for himself and his friends to an amount exceeding a crore of rupees. At the end of this period the Directors rescinded their previous resolution not to advance on shares, and authorised the Secretary to make such advances at his discretion up to limits which included in some cases a large part of the whole premium at which the shares were then selling. Advances were made on shares which had not been fully paid up and the Bank thus became liable for further calls. In the six weeks following the passing of this Resolution twenty-two advances were made on shares, on fourteen of which the Bank ultimately lost 13 lakhs. At this time there was a change of Secretary. The total loss during the management of the outgoing Secretary ultimately proved to be over 1½ crores.

- (3) *April 1865 to April 1866.*—At the beginning of this period the affairs of the Bank had begun to attract the serious attention of the Local Government and the Government of India, and rumours of its doings had reached the Secretary of State. But the improvement in management is said to have been very slight. A panic in Bombay in June 1865 caused a run on the Bank which was only stopped by the Government of India undertaking to advance 150 lakhs from the Currency reserve, if necessary. In August the Directors looked into the Bank's affairs and estimated that it had by that time lost only 30 lakhs. A little later the price of shares improved. The Directors might have used the opportunity to get rid of the shares which they held as security for unpaid loans, but preferred to pursue "a policy of forbearance," and the favourable moment slipped by.
- (4) *April 1866 to December 1866.*—In April 1866 the Directors advanced 25 lakhs to Premchand Roychand to prevent his stopping payment. He was already at the time indebted to the Bank to the extent of 23 lakhs. He failed in the following August leaving nearly 25 lakhs of the Bank's advances to him irrecoverable. The Bank also helped the Asiatic Bank in similar difficulties. In July 1866, this Bank owed the Bombay Bank 12 lakhs with "only one lakh of good negotiable securities to cover it." The Asiatic was allowed to continue drawing till September, when it failed owing 20 lakhs to the Bank of Bombay covered by securities "which were not negotiable" and included "the assignment of the stock in trade of a druggist and of claims on insolvent estates." In October the Bombay Legislative Council passed an Act (No. XV of 1866) depriving the Bank of the power to advance on shares.
- (5) *December 1866 to January 1868.*—By December 1866 "the Bank was ruined and virtually in liquidation."

In January 1867 the capital was reduced from two crores to one crore, but the R500 shares could only be sold at R250 each. In February 1867 there was another run on the Bank which was again allayed by the assurance of the Government that the Bank would be supported, but not till after 169 lakhs had been withdrawn in a few days. In August the loss of capital was estimated to be $1\frac{1}{2}$ crores. On the 13th January 1868 it was resolved to wind up the Bank voluntarily, and the new Bank of Bombay was apparently opened the same day. The Government left with the old Bank 25 lakhs of its balances to enable private depositors to be paid off in full and started the new Bank with 25 lakhs also,—the new Bank accepting the liability for the whole 50 lakhs.

It is not necessary to trace in detail the action taken by the Government of India to ascertain the true state of the Bank and avert its ruin. The Government began to move in the matter when in November 1863 the Bank was holding a cash balance of only 10 lakhs against liabilities payable on demand of 157 lakhs, including 40 lakhs of Government balances. There ensued a great deal of correspondence, marked by numerous delays, and before it was completed the Bank's affairs were beyond remedy.

CHAPTER IV

*RESTRICTIONS ON BUSINESS.

When the right of issue was withdrawn in 1862, the Banks were still working under the charters of 1839-43. The classes of business permitted by these charters differed but very slightly from those specified in the Bank of Bengal's first charter of 1809. The conditions under which the permitted operations could be carried out had become somewhat less stringent in the course of half a century, but they were still very precise and arbitrary. The early rule fixing a maximum rate of interest and discount (at 12 per cent) had disappeared, as also the rule that the total liabilities of the Bank (including notes) should not exceed its capital for the time being. But loans and advances were still restricted both as regards time and amount, a minimum cash balance of one-fourth of the outstanding liabilities had still to be maintained, and there were several other limitations of less importance. With the withdrawal of the right of issue it became necessary to revise the charters of 1839-43, and the Banks were asked to state what modifications were required. All the Banks concurred in demanding a general relaxation of restrictions, and in asking to be permitted to transact Government business and use the Government balances. But the Bank of Bengal was the only Bank which attempted to define the points in which the existing charter had been found inconveniently restrictive, or asked for any important enlargement of the permitted classes of business. It wished to be allowed to engage in exchange operations with England, and the suggestion must have met with some support, for in one draft of the Charter Bill a clause was inserted permitting the Bank of Bengal to engage "in banking in all its branches, particularly in discounting, buying and selling Bills of Exchange and other negotiable instruments payable in India, the United Kingdom of Great Britain and Ireland, or elsewhere." The proposal was,

* The provisions relating to business in the Charter Acts of 1839, 1862, and 1876 and in the amending Acts of 1879 and 1899 are reprinted in Appendix A.

however, viewed with apprehension by the Directors of the Bank of Bombay who thought the work unsuited to the character of the Presidency Banks, and it was ultimately dropped, probably because it was known that the Secretary of State would not agree to it. The only concession made in this direction was the grant of permission to remit funds to England for "constituents in the Agency Department" such as retired officers whose dividends the Banks collected in India and wished to remit to England by their own bills.

Though the Bank of Bengal was not successful in this part of its proposals, the alterations actually made followed very closely the lines the Bank itself had laid down. The following quotation is taken from a letter written by the Bank's Secretary on the 10th October 1860 :—

"In the near prospect of the withdrawal of the Bank's right of issue and the substitution of a national Paper Currency under the direct control of Government, I have been requested to draw up for consideration the general outlines of some arrangement, under which the loss thereby occasioned might be made up to the Bank and which, subject to modification, might at the same time prove acceptable to the Government and the Bank.

"The source from which the void caused by the withdrawal of the Bank's issues can be most advantageously and conveniently supplied is doubtless the public balances, which hitherto have been retained in the local Treasury."

[Here follow suggestions for the transaction by the Bank of Public Debt and Treasury work and for the use by the Bank of the public balances.]

"The contemplated changes will, moreover, render necessary considerable alterations in the Bank's charter. A large and an important accession of business might be obtained first by the withdrawal of the proviso which confines banking operations to India. It humbly appears to me that this restriction might be modified to the extent of permitting exchange operations with England with very beneficial results to the Bank. Meanwhile such operations might be carried on principally through the agency of the Bank of England and in a subsidiary manner through Messrs. Coutts & Co., or some other London House of equal standing.

"Should it be deemed advisable to undertake such business, then it naturally follows that the 27th Section of the Existing Deed of Co-partnery be set aside in so far as it restricts (1st) the Bank to the discount of Bills of a limited currency and carrying the several responsibilities of at least two persons or firms unconnected with each other in business, and (2nd) in so

far as it limits the amount of advances to one firm or individual to three lakhs of rupees. Looking to the ample and extended experience which the Directors have now had of banking in India, it humbly appears to me that beyond enacting *the descriptions* of business to be undertaken by the Bank the practical details would be more advantageously managed by a code of bye-laws, which would be equally binding on the Bank, but which could be modified or altered from time to time as circumstances might require and the Directors might recommend for the adoption of the shareholders.

"Such generally is the practice of the Bank of England and of most of the great Banking Institutions with which I am acquainted, for, after all, it will be found that success will follow prudent and judicious directorial management in properly regulating the rate of discount whereby inconvenient reductions in the amount of the reserve are in due time prevented instead of relying upon the self-regulating powers of any law or provision in a deed of co-partnery.

"And this now leads me to notice the 26th clause of the existing contract, under which the Bank is debarred from discounting any negotiable security or making any loan, unless the amount of cash in possession of the Bank and immediately available shall be equal to one-fourth of all the claims against the Bank outstanding for the time being and payable on demand.

"No doubt every well-regulated Bank lays down, as a general principle, that a certain fixed amount of coin and convertible securities shall, if possible, be retained in reserve to meet the public demands. Yet in practice it has been found impossible to adhere to this principle in its integrity.

* * * * *

"Viewing the Bank of Bengal divested of its powers of issue, I presume it will be deemed unnecessary to introduce or continue any such restriction, except in the event of the Government depositing the whole of the public balances. In that event probably a reserve of one-half the amount in excess of the proposed minimum may be specially held in reserve.

* * * * *

"There are many other subsidiary questions arising out of a revision of the existing charter—in particular the expediency of forming a Reserve Fund; of opening branches and enlarging the Bank's capital; of extending the limits of lending to the State for temporary purposes by deficiency bills or otherwise, but these matters fall more properly to be discussed hereafter, when the several clauses come specially under consideration.

"Should the extension of branches and enlargement of the Bank's capital be assented to, I would respectfully take leave to point out that a simultaneous trial of the branch system might in the first instance and are

long advantageously be made throughout the three Presidencies at a limited number of the larger cities."

The new Acts, which were the outcome of these negotiations, were Act IV of 1862 applying to the Bank of Bengal, Act V of 1862 applying to the Bank of Madras, and Act X of 1863 applying to the Bank of Bombay. The last Act was somewhat wider in its provisions than the other two, but generally it may be taken that anything said of one applies equally to all three.

The Bank of Bengal's Charter Acts of 1839 and 1862 both permitted in much the same terms the buying and selling of bullion, the receiving of deposits, the issuing of post bills, and the sale of property deposited as security for loans which had not been repaid. But the Act of 1862 differed from that of 1839 (a) in not giving a right of note issue, (b) in the definition of the conditions on which the Bank might conduct its loan and discount business, and (c) in adding certain classes of business to those which the Act of 1839 had permitted.

With the withdrawal of the right of issue the condition that the Banks should maintain a minimum cash balance became unnecessary, and the new Charter Acts omitted it.

The differences included under the second of the above heads were of great importance.

A Bank's advances (whether by way of loan or discount) may be given either on real (or tangible) security or on personal security, and this was, of course, recognized by both Acts.

So far as related to the advancing of money on real security, there was little difference between the two Acts. The only real security recognized by the Act of 1839 was that of Government paper or of goods. The Act of 1862 added to these the shares of Guaranteed Railways, a class of security which had already been admitted by Act XXI of 1854. The corresponding provision of the Bombay Charter Act (X of 1863) ran as follows:—

"The advancing and lending money on Government securities or on the security of shares in any of the Incorporated Indian Railways or other public companies in India."

There was much question a few years later as to how the italicized words in the above extract found their way into the Bill, but it is certain that they were not inserted in pursuance of any deliberately settled policy. The Banks did not in 1862 or even in 1876 ask for the recognition of securities which were not guaranteed, absolutely or practically, by the Government. The words "or other public Companies in India" were excised in 1866 by an amendment of the Bombay Act, and it was of course important that they should not be allowed to stand as a direct encouragement to speculative business. But they do not appear to have been the main cause of the failure of the Bank of Bombay. The Commission which reported on that failure stated that at the time they wrote the ascertained losses by advances on shares were 41 lakhs (excluding some items of unnamed amount), while the losses during the same period arising from the practice of granting advances on promissory notes in the name of a single person were 80 lakhs. The failure was really due to the absolutely unlimited freedom which the Acts of 1862-63 gave in the matter of advances on personal security. A Board of Directors, which could grant such advances without any restriction, could also indirectly advance on shares, whether the power to do so were formally recognized or not.

Coming, then, to the question of advances on personal security, we find that the Act of 1839 enforced the following restrictions:—

- (a) The instrument discounted or the loan granted was not to be current for a longer period than three months.
- (b) The security taken was to be that of at least two persons unconnected with each other.
- (c) The total loans and discounts granted to a single individual were not to exceed 3 lakhs.

The Bank of Bengal's charter of 1862 simply stated that the following classes of business might be transacted without attaching any conditions:—

- (i) drawing, discounting, buying and selling bills of exchange and other negotiable securities payable in Her Majesty's Indian Territories, and not elsewhere;

(ii) lending on Government securities and shares in railways the interest whereon shall have been guaranteed by Government, and on goods, wares and merchandise not of a perishable kind ;

(iii) opening cash accounts and credits.

The Act thus allowed the discount of a promissory note signed by a single person, while the permission to "open cash credits" without any specific provision as to security was capable of being construed as permitting unlimited advances without even nominal security. The Act also withdrew the prohibition against overdrafts, and the Bank of Bombay permitted one constituent to overdraw his account by 5 lakhs.

The full significance of these modifications was evidently not realized when the Bills were under consideration. The intention was to cancel restrictions which the withdrawal of the right of issue had seemed to render unnecessary. The Government went distinctly further than was desirable in this direction ; but even so it might have been thought that with intelligent official Directors they would at least have been sure of receiving timely information of any tendency to use improperly the powers conferred partly by intention and partly by bad drafting. As a matter of fact, the Bank of Bengal does not appear to have taken advantage of the excessive liberty which the letter of the law conferred on it, and, so far from meeting with disaster itself, it was able to be of immense assistance to commerce during the critical years which led up to the collapse of the Bank of Bombay. The bad debts of the Bengal Bank during the 10 years from 1860—1870 amounted to less than 7 lakhs on a turn-over of 77 crores. This success was attributed by Sir C. Jackson, the President of the Bombay Bank Commission, to the fact that the Bank of Bengal's Secretary, Mr. G. Dickson, "was the most able Bank Manager in India and perhaps in the world." The case was different with the Bank of Bombay. It fell into the hands of unscrupulous Secretaries and incompetent Directors, who, like every one else in Bombay, "became wild with the spirit of speculation." It is well to remember that the failure of the

Bank was due as much to the special circumstances of the times and the perverse incompetence of individuals as to the dangerous laxity of the charter. Though Sir C. Jackson's Committee laid much stress on the last-mentioned cause, they fully recognized the importance of the others. One member observed* that "a bad Secretary, if left equally unrestrained, could and would nearly equally easily have abused the powers given in the old or any other Act, adhering to their letter, but violating their spirit." Sir C. Jackson prefaced his examination of the various classes of legitimate banking business and securities with the head line "safe business, but not too much restricted." He had no desire to rely on the rules of a charter as a substitute for the personal element in banking, and his suggestions on the subject of banking business are so little prejudiced by the circumstances under which he wrote that they could still be read with profit. If he took on any point an illiberal view, it was on the question of the Government control and partnership. The Government connection with the Presidency Bank was undoubtedly anomalous, and he hardly seems to have given full weight to the special circumstances which partially justified such an anomaly.

The additions which the Charter of 1862 made to the classes of business which the Bank of Bengal might transact were as follows:—

- (a) the transaction of Government Treasury work and the superintendence of the issue of Government Currency notes;
- (b) the making of investments in securities of the Government of India or in loans or bonds secured by the Imperial Parliament on the revenues of India or in debentures of Railways guaranteed by the Government of India;
- (c) the transaction of pecuniary agency business on commission;

* See also footnote on page 14.

(d) the drawing of Bills of Exchange and granting of Letters of Credit payable out of India for the use of constituents in the Agency Department and the buying of Bills of Exchange payable out of India for the purpose of remitting funds to meet such Bills or Letters of Credit.

The circumstances under which the Banks were permitted to transact Government treasury and currency business are fully noticed elsewhere.

The earlier charters had not contained any reference to the investment of the Banks' funds. The Bank of Bengal had held investments in Government paper from the first, and the clause on the subject in the Act of 1862 did not so much convey a new power as define an existing one.

The earlier charters had prohibited the Banks from engaging in agency business, but the restriction had already been modified by Act XXVII of 1835, which permitted the Bank to purchase and sell Government securities or the shares of the Presidency Banks and receive the interest or dividends on behalf of their constituents. The same Act had prohibited them from remitting the proceeds by drawing Bills payable out of India. The withdrawal of this restriction was at once noticed by the Secretary of State, who addressed the Government of India on the subject in a despatch of 16th September 1862 as follows:—

“I must now advert to a material point in connection with the privileges conceded to the Banks of Bengal and Madras, and, I suppose, of Bombay, viz., the power of dealing in foreign exchanges.

“It appears to Her Majesty's Government to be very objectionable to allow Banks so intimately connected with the Government as these Banks, and which are entrusted with the custody of the Government balances, to deal in foreign exchanges. The Bank of England does not transact business of that description, which is, in fact, not banking, but speculative commercial business.

“The question of giving a power to deal in foreign exchanges to the Bank of Bengal, which is now proposed, was formerly and on different occasions considered, and that power was always withheld. It is still more objectionable to give it when, as proposed by you, the business of issue is, in a greater or less degree, connected with the business of the Bank.

"Any Bank to which the balances and treasury business of the Government are to be entrusted must be restricted to legitimate banking operations, such as those transacted by the Bank of England, or by the Bank of Bengal as heretofore constituted.

"This precaution is indispensable, for it cannot be conceived that a failure on the part of the Bank entrusted with the business of Government to cash a Government note or bill, or to pay any legal demand on the Government, would be held by the Native community to affect only the credit of the Bank. Her Majesty's Government consider that any such occurrence would inevitably be regarded as a failure on the part of the Government itself, and the utmost care must be taken to guard against the possibility of such a contingency.

"I must desire, therefore, that you will not conclude the arrangement which you were about to make with the Bank of Agra, which deals in foreign exchanges, and Her Majesty's Government cannot sanction the concession which you have made to the Bank of Bengal of allowing it to deal in those exchanges. I have not, however, advised Her Majesty to disallow the Act IV of 1862, which gives effect to your intention in this respect, in order to give you an opportunity of making provision for the other objects of the Act."

The Government of India at once explained that the power granted did not amount to "the power of dealing in foreign exchanges" in the ordinary interpretation of the term:—

"The Banks did not ask for, nor did we ever intend to grant, any such concession. We considered, however, that the Banks should be enabled to remit to England, in their own Bills or by Letters of Credit, dividends received for their constituents in the Agency Department, which is quite separate from the Banking Department, being, like the old Government Agency which it succeeded, entirely confined to business connected with Government securities (of which about £9,000,000 are deposited with the Bank of Bengal); and as any measures calculated to facilitate remittances of this description must tend materially to improve the character of Indian securities in the estimation of the English public, it is very desirable, on that ground as well as for public convenience, that the limited concession should not be withdrawn."

The Secretary of State, however, adhered to his objection observing in a Despatch of 10th June 1863:—

"I cannot, however, give up the condition on which alone any Bank can be entrusted with the Government business, and that is, that it should be debarred from dealing at all in Foreign Exchanges."

In spite of another representation from the Government of India, the Secretary of State, in a Despatch of 4th January 1864, adhered to his decision that the right of making these remittances must be surrendered as soon as the current agreements came under revision, and it was actually withdrawn, with effect from the 2nd January 1866. The Bank of Bengal, however, renewed its protest in a letter of 20th February 1866, but the Secretary of State, in a Despatch of 4th June 1866, refused to give way, and suggested that the Bank might meet the difficulty "by the issue of post bills payable in India, which will find always a ready sale in England; or by permitting constituents to draw upon the amount at their credit on the Bank by cheques or bills payable to order." The Bank replied that the terms on which remittances could be effected in this way would be so unfavourable as to drive their constituents to deposit their securities in the Exchange Banks, and that many Government servants had already suffered loss by the failure of some of these Banks. The Government strongly supported the Bank, and proposed to relax the prohibition on the following conditions:—

- (1) that the power of purchasing bills should be restricted to the Agency Department;
- (2) that such bills should be drawn on England only and on Banks not in partnership with the drawers;
- (3) that the usance of such bills should not exceed three months;
- (4) that periodical returns should be made to the Government of India of the number amount and date of bills outstanding with the gross total of assets in the Agency Department of the Bank.

They forwarded also an extract from the Proceedings of the Madras Legislative Council, in which strong objection had been taken to the prohibition, and contended that its continuance would discourage retiring officers from leaving money in Indian investments. The last argument apparently appealed to the Secretary of State, for in a despatch of 15th December 1866 he reluctantly conceded the privilege, subject to the conditions

suggested by the Government of India, "and on the distinct understanding that no bills should be drawn except for the remittance of interest and dividends on Government securities and Bank shares in the Bank's custody, and that, in the event of its appearing that any risk or inconvenience not at the time foreseen would be incurred, the concession would be withdrawn."

It is possible that, if this concession had been less strenuously opposed, an attempt would have been made to secure the privilege of dealing in foreign exchanges generally; but the attitude of the Secretary of State on the minor point made it obviously futile to raise the larger question. Nor was it likely that any important extension of powers in other directions would be conceded while the recollection of the mismanagement and failure of the Bank of Bombay was still fresh. We find therefore that there was no agitation on the part of the Banks for greater freedom during the ten years which succeeded the charters of 1862 and 1863, and when the decision of the Government to surrender their shares in the Banks was announced in 1872, and it became obvious that the charters must be revised in consequence, the Banks still showed no desire for any change in their constitution. The Government of India, after consulting the Banks, addressed the Secretary of State in a despatch of 9th June 1873 regarding the disposal of their shares and the new agreements for the transaction of Government business. In this despatch they dealt incidentally with the intended revision of the charters, observing that "the Acts of Incorporation and the bye-laws will comprise such restrictions and conditions as must, if enforced and observed, ensure safety according to reasonable calculations in banking affairs," and, again, "investment will be permitted in guaranteed railway shares* and legally authorized debentures of the Presidency municipalities, and loans will be allowed on the security of such debentures. It is important to extend the field of investment so far as it can be done without any risk." This suggestion had not originated

* Investment in guaranteed railway debentures was already permitted by the Acts of 1862-63, as also loans on guaranteed railway shares.

with the Banks. It was due rather to Mr. Chapman, the Financial Secretary, who seems to have taken it from Sir C. Jackson's report. A draft Bill on these lines was submitted to the Banks for consideration in September 1873. The letter forwarding the Bill to the Government of Bombay mentioned that the Government of India were not willing to allow the Banks to make advances on mortgages of rates and taxes of municipal corporations, such mortgages not being "sufficiently marketable to be a good banking security." The letter also disallowed advances by one Presidency Bank to another otherwise than upon the security prescribed for advances generally. The suggestions here negatived were based on Sir C. Jackson's recommendations, and had probably been brought forward by the Bombay Government in preparing a draft Act of Incorporation for the reconstructed Bank. This special Act for the Bombay Bank never, however, became law, as, before it could be passed, the revision of the other charters had been taken up and the Presidency Banks Act of 1876 dealt with all three Banks together.

The Bombay and Madras Banks forwarded their opinions on the draft Bill in October and November 1873. They raised little or no objection to the proposal made in the Bill to re-enact some of the restrictions which the Act of 1863 had removed; nor did they ask for larger powers in the matter of advances and investment than the Bill permitted. Similarly, the reply of the Bank of Bengal, which was not received till November 1875, raised no important questions of policy. Objection was taken, however, to the re-imposition of the limit of three lakhs on advances to individuals, and the Bank succeeded in getting this matter relegated to the bye-laws. The maximum laid down in the Bank of Bengal's bye-laws is now six lakhs.

The Presidency Banks Act of 1876 in its final shape was drafted with much greater precision than the Acts of 1862-63, and its provisions on the subject of business cannot easily be abridged. It re-imposed the time-limit of three months on loans and discounts, and restored with some modification the rule requiring that advances and discounts on personal security should be secured by the responsibilities of at least two persons.

Cash credits were treated as any other form of advances, and henceforward could only be granted on regular security. The overdrawing of an account to the extent of more than ₹2,000 was prohibited (the margin being allowed to provide for cases of accidental overdrawal). It was also laid down, as noticed above, that the bye-laws of each Bank should fix a limit for advances on personal security. Some additions were made to the securities on which the Banks might make advances, the full list being as follows :—

- (1) promissory notes, debentures, stock and other securities of the Government of India, or of the United Kingdom of Great Britain and Ireland ;
- (2) bonds, debentures and annuities charged by the Imperial Parliament on the revenues of India ;
- (3) stock or debentures of, or shares in, Railway or other Companies, the interest whereon shall have been guaranteed by the Secretary of State for India in Council ;
- (4) debentures or other securities for money issued by, or on behalf of, any municipal body under the authority of any Act of a Legislature established in British India ;
- (5) bullion or other goods which, or the documents of title to which, are deposited with, or assigned to, the Bank as security for such advances ; and
- (6) accepted bills of exchange and promissory notes endorsed by the payees.

Bills of exchange had been added because, as the Banks could discount them, it seemed anomalous that they should not also be able to lend on them.

The area of investment was also extended to the first four of the above classes of securities.

These, it will be observed, are all absolutely guaranteed securities except those in the fourth class, which are issued with the sanction of the Government on the credit of corporations over which the Government has considerable power of control. The old list, though based on the same principle, was much

more limited, including only Government securities and guaranteed railway shares (in the case of advances) and Government securities, loans on bonds secured by Parliament on Indian revenues and guaranteed railway debentures (in the case of investments).

The classes of business formerly transacted were in some cases described in different language, but no new class of business was added except that defined in the following clause:—

(k) The acting as agent on commission in the transaction of the following kinds of business (namely):—

- (1) the buying, selling, transferring and taking charge of any securities, or any shares in any public company;
- (2) the receiving of the proceeds, whether principal, interest or dividends, of any securities or shares;
- (3) the remittance of such proceeds at the risk of the principal by public or private bills of exchange, payable either in India or elsewhere.

This was an extension of Act XXVII of 1855 (referred to on page 44).

Next came the provisions about remitting dividends to England, which were reproduced in the following form:—

- (l) The drawing of bills of exchange, and the granting of letters of credit, payable out of India, for the use of principals for the purpose of the remittances mentioned in the last preceding clause of this section;
- (m) the buying, for the purpose of meeting such bills or letters of credit, of bills of exchange payable out of India, at any usance not exceeding six months.

It would appear from this that the elaborate conditions on which the privilege had been conceded by the Secretary of State had soon been found superfluous. No restrictions are now imposed except those specified in the Act itself.

It was soon discovered that the new Act left one important matter unprovided for. In September 1877 the Presidency

Banks joined in a representation to the Government asking that the Act might be amended so as to expressly authorize them to borrow money either in India or England by pledge of assets or otherwise, and to make remittances to England by bills of exchange or otherwise, in repayment of loans arranged for in England, or in payment of the price of stock or other authorized investments purchased or acquired for the Banks in England. The Banks had been advised by Counsel that the Act of 1876 probably debarred them from borrowing in England, and certainly debarred them from drawing bills on England. It was doubtful, however, whether it did or did not permit them to borrow in India. The matter was referred to the Secretary of State with the nearest approach to a favourable recommendation which the Government of India felt able to make in view of the objections of successive Secretaries of State to anything like dealing in foreign exchanges. The Secretary of State did not object to the amendment of the Act so as to legalize borrowing in India, but he refused to permit borrowing in England, supporting the old argument as to the speculative character of exchange business by the further consideration that "the concession of a power of creating a foreign agency in England, such as would be the result of entering into loan transactions of the nature of those contemplated, would admit of the Banks locking up a large portion of their capital at so great a distance as to render it practically unavailable in the case of any emergency arising in India."

The Government of India, before proceeding to amend the Act, invited suggestions as to any further modifications which might be desirable. The Bombay Bank pointed out that the clause in the Act of 1876 permitting the Banks to lend on certain English securities must be practically a dead letter so long as the Banks were not permitted to have agencies in England. They also asked to be allowed to lend on one name only. The Government of India negatived both these suggestions. They agreed, however, to a proposal made by the same Bank to add Port Trust debentures to the list of authorized securities. It was also at one time proposed to add "public securities guaranteed by a Local

Government," but the proposal seems to have been dropped, probably because Local Governments have not the power of guaranteeing loans which the phrase implies. The word "public" in that phrase was inserted to exclude such a transaction as the grant of a loan to a Native Chief on the security of a Local Government. A minor alteration made was the concession to the Bengal and Bombay Banks of the power to draw bills on Ceylon which had been confined to the Madras Bank by the Act of 1876. The Secretary of State took objection to this as giving the two Banks the "power to deal with foreign exchange," but did not interfere, as the Bill for giving power to borrow in India had then become law as Act V of 1879.

The Madras Bank has always had intimate trade relations with Ceylon, and has had a branch at Colombo for thirty years or more. In 1886 the Bank enquired informally whether the Government of India would be likely to agree to an amendment of the Act of 1876 permitting it to invest in and lend on securities of the Ceylon Government. It was explained that the Bank was already the principal banker to that Government, but could not undertake the whole Government banking business unless the disability referred to was removed.

Sir James Westland, in stating the objections to this proposal, developed the argument previously used by the Secretary of State when the Banks had wished to borrow in England. He pointed out that the funds of the Presidency Banks should be retained in India to enable the Banks to assist Government when necessary, and also "to ease off the demands of Government upon the market" by keeping in India "the moneys which in a full treasury time are withdrawn by Government from the market. *Prima facie* Government should keep its money at its own disposal, and, if we refuse to lock it up idle in vaults, it is because we recognise the necessity of not withdrawing motive power from local commerce and therefore leave it in the Banks to be used for local commerce." The proposal appears to have been referred to the India Office before being negatived. Again in 1892 the Government refused to permit the Bank of Madras to open additional branches in Ceylon, the objection taken to this

proposal being that it was barred by the terms of the Presidency Banks Act.

The Bank of Madras renewed both the requests just noticed in 1893, and asked that the Presidency Banks Act might be amended accordingly. It was urged that the existing branch at Colombo had always been self-supporting, and that, so far from drawing on India for funds, it had in fact remitted funds to India. On this occasion the Government thought that the proposal did not involve "any material risk." It was, however, negatived by the Secretary of State on the grounds that it was highly important "to maintain the essential condition of a Presidency Bank that it shall not deal in foreign exchanges or be allowed to establish branches out of India"; that it seemed "doubtful whether the existing capital of the Bank would be sufficient in case of any great development of its business in the Colony"; and that it was by no means certain that the assets of the Ceylon branches would always show an excess over liabilities, and that, "on an emergency arising, the Bank might be compelled to send to Ceylon a considerable portion of its Indian assets." The Secretary of State also alluded to the possibility of either Ceylon or India changing its currency and to the undesirability of permitting the funds of the Banks to be invested in the securities of another Government.

Except for these special requests in connection with Ceylon securities, the Banks for many years refrained from asking for any addition to the powers of lending and investing conferred by the Acts of 1876 and 1879. Apparently, the first and only important proposal of the kind was made in 1895. The Bank of Bengal then suggested that the Presidency Banks should be permitted to invest in and lend on the stocks, shares and debentures of assisted Branch Railways. The terms on which the State would subsidize such lines were under consideration at the time. Under the terms finally settled, the Government undertook to offer one of two alternative concessions to promoters of approved projects. The first was the guarantee of a minimum return of 3 per cent on "the actual expenditure charged on the capital account of the Branch Railway Company as entered in rupees

in the Company's books in India." The second was a payment (to be made by the main line) of such amount, not exceeding the net earnings of the main line from traffic interchanged with the branch, as would bring the total earnings of the Branch line up to $3\frac{1}{2}$ per cent on the capital expenditure as above defined.

The Government refused to legislate with a view to admitting the securities of Railway Companies which had received the second concession to the list of "authorized securities." The position of companies floated with a 3 per cent guarantee was different, and the Bank of Bengal, on subsequently taking legal opinion, was advised that the Act of 1876 as it stood permitted advances on and investment in such securities.

In 1890, at the instance of the Bank of Bombay, the Act was amended by the inclusion of the securities of the Bombay Improvement Trust, these being securities which, in effect, are guaranteed by the Government.

CHAPTER V.

THE NOTE ISSUES OF THE PRESIDENCY BANKS.

Probably the first banking institution in India, on European lines, was the Bank of Hindustan which was established in Calcutta about 1770 by a private trading firm. The notes of this Bank, though not recognized by the Government, obtained a local circulation which occasionally reached 40 or 50 lakhs and generally averaged about half that amount. It is said that they were "received for many years at all the public offices in Calcutta scarcely excepting the Treasury itself." On two occasions, once in 1819 and again in 1829, the occurrence of a panic led to the presentation for payment of about 20 lakhs worth of the notes, and the demand was promptly met. At least one other private Bank of issue was in existence before 1800, but no details of its operations are known. There was also the so-called Government Bank which Lord William Bentinck, the Governor of Madras, established at Madras about the beginning of the century. Cooke's "Banking in India" says that it "conducted business on a very small scale and had a circulation of a very limited amount." Probably it was more of a Treasury than a Bank. The Treasury Bills by which the Government raised funds at that time were also a species of paper currency. But they were expressed in amounts which were too large for the Bills to be a popular form of currency, and, though bearing interest, they circulated at a considerable discount and they were of course inconvertible. It was partly with the object of assisting in the gradual withdrawal of these Bills from the market that the Bank of Bengal was created, and its notes were originally issued only in exchange for Treasury Bills and for a short time were payable in the same currency. In a few months, however, it was decided to pay all notes in specie on demand.

The charter of 1809 empowered the Directors to issue "promissory notes payable on demand for amounts of not less than £10 and not more than £10,000." No special provisions were

made for limiting the total issue or for otherwise ensuring the credit of the notes. These points were no doubt considered to be sufficiently provided for by two general limitations contained in the charter, to the effect (1) that the total liabilities of the Bank should not exceed the Bank's capital of 50 lakhs, and (2) that the actual cash in hand should never fall below one-third of the outstanding claims payable on demand.

The limited circulation permitted by the charter of 1809 was "found insufficient to meet the demands of the community," and the Directors were empowered in the Bank of Bengal's second charter granted in 1823 to extend the note issue as they might "deem expedient for the public accommodation" up to a maximum of four times the Bank's capital which then stood at half a crore. The same charter reduced the minimum cash reserve to one-fourth of the outstanding claims.

The charter of 1839 definitely fixed the maximum note circulation at two crores, instead of four times the capital for the time being, thus nominally curtailing the issue previously allowed, as the Bank's capital was at that time more than a crore. But the limitation had little practical effect as the normal circulation never reached two crores.

In 1840 the Bank of Bombay was founded with a note issue limited to two crores, and three years later the Bank of Madras with a note issue limited to one crore. The latter Bank took the place of the "Government Bank of Madras," the note issue of which was discontinued.

But few particulars are obtainable of the former note issues of the Presidency Banks. The following details relate to the Bank of Bengal only.

The Bank's notes were not made legal tender or even accepted by the Government unconditionally, for, in accordance with an understanding referred to in the charter, the Government required the Bank in 1809 to deposit 20 lakhs of Company's paper in the public Treasury as security for the credit given by the Government to the Bank in receiving its notes. In 1822 the Government considered that, as the principal shareholder in the Bank, it was their duty to dispense with this special security;

but it was not till 1835 that the Court of Directors consented to the removal of the condition.

The Government in the first instance only accepted the Bank's notes at Calcutta, but shortly afterwards directed their acceptance at all Government Treasuries in the Lower Provinces. The order limiting the recognition of the notes to Bengal seems to have been still in force in 1836, for in that year we find the Bank asking the Government to accept its notes at Treasuries in the North-Western Provinces in connection with a proposal to open a branch in Allahabad. The Government refused to do this unless the Bank made its own arrangements for cashing its notes on the spot, adding "the Bank is no doubt aware that any existing available surplus of the North-Western Provinces is drawn down to Calcutta by bills of exchange granted on terms affording a profit to the Government." Again, while willing to receive the notes in a limited area, the Government did not under any circumstances cash them even in the Lower Provinces, or re-issue them except when "demanded by those willing to receive them." Moreover, under the orders of the Court of Directors the Government were required to prevent the accumulation in their Treasuries of more than 50 lakhs * worth of notes by presenting the excess at the Bank for immediate payment. This order seems to have been repeated in 1848 and regarded, by the Secretary of State at any rate, as operative up to the close of the period during which the Bank enjoyed the right of issue.

No doubt the Government held more than half a crore for short periods, for even in 1834 the Court of Directors complained of their holding as much as 72 lakhs worth of notes. Generally, however, it may be said that the only assistance and recognition given by the Government to the Bank's note issue was that they agreed to accept a limited amount of the notes at the Treasuries contained in a limited area, but did not cash them or actively facilitate their re-issue.

* Originally the limit was 20 lakhs corresponding to the special security of 20 lakhs taken by the Government.

When the Bank began to consider its policy in the matter of opening Branches it realized that the convertibility of its note issue at a distance from Calcutta would be a matter of special difficulty. It was proposed to meet this difficulty by issuing notes payable only at the Branch Office, or, by favour, at the Head Office also. To secure these notes, a cash reserve equal to one-fourth of the value of the Branch notes in circulation was to be kept at the Branch. As, however, no Branches were opened until a few months before the withdrawal of the right of issue, this suggestion* was never actually carried out, and probably the Bank did not succeed in inducing the Government to accept its notes outside Bengal.

This explains the failure of the Bank to enlarge its circulation to the extent which might have been anticipated. That there was such a failure is evident. As early as 1823 the Bank thought it necessary to take power to issue notes up to the amount of 2 crores, and apparently an average of 120 lakhs was actually in circulation for a time about the year 1829; yet in the six years preceding the withdrawal of the right of issue in 1862 the highest average circulation reached was only 176 lakhs, while in two of the six years the circulation was under 150 lakhs. In the hands of Government the circulation doubled in the first three or four years, though the facilities for conversion were inadequate and the success attained fell short of what had been anticipated.

The Bank's note circulation was in fact "imperfect" as a letter written by the Bank in 1867 admits; and this imperfection was due to the absence of facilities for turning the Bank's notes into coined money elsewhere than at Calcutta. The Bank preferred the profits of an internal exchange business to those of an extended note issue. The Government could not be expected to bear the cost of remittance themselves while they had no share in the profits of the note circulation. The point is of some importance in connection with the discussion on the Government Paper Currency scheme. There was probably no want of confidence in the Bank's ability to honour any notes duly presented for

* See also footnote on page 8.

payment at Calcutta; there has never, it is believed, been a "run" on this Bank either in connection with its notes or its deposits. The greatest fall in the weekly average circulation during the mutiny did not exceed 25 lakhs in a single week. The maximum weekly average circulation in this period was 183 lakhs at the end of July 1857 and the minimum 108 lakhs at the beginning of November and again in December. The need for a sound paper currency may be judged from what is said of Mirzapur about the year 1840. The coinage there was so debased that it took a whole day to count a few thousand rupees, and the merchants of the place in their dealings with one another used sealed bags containing a thousand rupees each which passed freely from hand to hand without being opened and counted.*

Mention has been made of the note issue of private banks in Calcutta. These banks appear to have been rather branches of trading and agency firms than banks proper, and disappeared in the commercial disasters of 1829—1832. Out of their ruin rose the Union Bank, a Joint Stock Bank created by co-operation among all the leading Calcutta houses, and apparently transacting purely banking business only. For a time the Bank of Bengal freely accepted the notes of the new bank, though there was a possibility of its becoming a formidable rival. But in 1834 it decided to refuse them, and its monopoly of Government recognition enabled it to persevere in that decision in spite of much protest on the part of persons interested in the Union Bank who attributed the action of the Bengal Bank to the desire to "strangle the infant Hercules." The notes of the Union Bank never again had a circulation of more than a few lakhs and the Bank itself disappeared in 1848. The circulation of the private banks of issue still existing in 1861 is not known, but was probably insignificant as their right of issue was withdrawn absolutely by Act XIX of 1861 without compensation of any kind.

There is one important incident connected with the Bank's right of issue which requires notice before the arrangements

* These bags, to the number of 600, were still current in 1866 and the Government notes had entirely failed to displace them, though a currency agency (the Branch of the Bank of Bengal) had then been established at Mirzapur for several years.

introduced by Act XIX of 1861 are examined. The limit of 2 crores was so far above the Bank's ordinary circulation that till almost the very end of the note-issuing period a wide margin was left for the fiduciary issue of notes in times of pressure. For every thousand rupees added to its reserve the Bank could issue notes to the value of four thousand rupees till the limit of 2 crores was reached. The limit was actually reached in 1860, when there were great demands on the Bank for accommodation in respect of subscriptions to the Government $5\frac{1}{2}$ per cent loan of that year. The Government permitted the Bank to issue notes up to the amount of 275 lakhs, and in consideration of the fact that the excess notes were practically all held in the public treasury and really represented an advance from the Government to the Bank, the Bank was charged interest on the excess at the rate of 5 per cent per annum. It is believed that this is the only instance of the limits prescribed by the Charters of the Bank being exceeded.

CHAPTER VI.

THE GOVERNMENT PAPER CURRENCY.

The establishment of a Government Paper Currency was first suggested in the early part of 1859, and Mr. James Wilson discussed the question with the Secretary of State before leaving England to take his seat as Financial Member at the close of that year. Mr. Wilson was no doubt much attracted by a project which offered, as he thought, the prospect of a large addition to the revenue as well as the opportunity of testing the truth of economic doctrines which he had warmly advocated in England. In a minute of 25th December 1859 he expounded his views on the subject of an Indian Paper Currency in some detail.

The following are the leading propositions which he laid down :—

- (a) The notes should be legal tender.
- (b) The entire sum received for the notes should be retained as security for their convertibility.
- (c) The Paper Currency Department should be a Department of the Government entirely dissociated from Banking institutions on the one hand and the regular executive Government on the other.

He proposed to hold not less than one-third of the reserve in cash to secure "the immediate convertibility of any probable proportion of notes likely to be presented," and to invest the rest in Government securities "to specially secure the ultimate payment of the whole."

India was to be divided into "Circles of issue" and the notes were to be payable at the option of the holder either at the office of issue or at the Presidency town of the Presidency in which the circle of issue was situated.

The "Department of Issue," by which the scheme was to be worked, was to be a large Department connected with the Mint and having its officers at every circle. These officers were to be

removeable by the Secretary of State and their duties were to be strictly defined by an Act of the Legislature.

There is no doubt also that he intended the number of the circles of issue to be very large indeed, and that he expected, by insisting on these safeguards and offering these facilities, to speedily displace a great part of the coined money in circulation by Paper currency, and so to obtain for the Government an important revenue in the interest which would be saved on the invested portion of the reserve.

This idea of making the Government Paper currency a direct source of profit was an essential feature of Mr. Wilson's scheme, or at any rate was so regarded by those who wrote on his proposals. Mr. Laing who succeeded Mr. Wilson gave the following figures as a possible estimate of Mr. Wilson's expectations :—

Number of circles of issue—40 or 50.

Amount of coin to be displaced by notes—half the estimated circulation of 90 crores.

Saving in interest to Government— $1\frac{1}{2}$ crores.

As regards the proportion of the reserve which could safely be invested, Mr. Wilson might or might not have adhered to the particular fraction (two-thirds) which is mentioned in his minute. But it is evident that his expectation of profit and indeed his whole scheme rested upon the supposition that the proportion which could safely be invested would be considerable. From the view that the scheme could or should be worked with a view to direct profit, the Secretary of State (Sir Charles Wood) entirely dissented. In a Despatch of 26th March 1860 he stated his own views as follows :—

“The sound principle for regulating the issue of a Paper circulation is that which was enforced on the Bank of England by the Act of 1844, *i.e.*, that the amount of notes issued on Government Securities should be maintained at a fixed sum, within the limit of the smallest amount which experience has proved to be necessary for the monetary transactions of the country; and that any further amount of notes should be issued on coin or bullion, and should vary with the amount of the reserve of specie in the Bank, according to the wants and demands of the public.

" I presume that provision will have been made, by some arrangement with the Bank of Bengal, for the withdrawal of their notes from circulation ; and probably the amount of their issues may be safely assumed as the minimum note circulation for Calcutta and the neighbouring districts. This amount might, therefore, be issued in the first instance, Government Securities to the same amount being held by the Currency Commissioner. There appears to be no reason to doubt that notes to that amount would always remain in circulation, under ordinary circumstances. All notes beyond this amount are to be issued only in exchange for coin or bullion, which will be held in reserve by the Currency Commissioners.

" It must always be borne in mind, that it is from the benefits naturally arising to trade and commerce from the establishment of a sound Paper currency, that the principal advantage to the State must be anticipated ; but the working of the proposed measure ought not eventually to entail any loss on the Government ; and to guard against the possibility of such a result, all the arrangements for carrying it into effect should be devised with regard to strict economy."

The Government of India were inclined to think that Mr. Wilson's real intentions and the Secretary of State's views amounted to very much the same thing, but Mr. Laing pointed out that the objections of the Secretary of State were fundamental. Thus, in a minute written about January 1861, Mr. Laing observed of Mr. Wilson's scheme :—

" The aim of that measure undoubtedly was to inaugurate a system under which a vast Paper circulation should ultimately take the place of the precious metals in India, secured in public confidence by the self-acting regulation of retaining one-third of the amount in specie, and affording to Government the large banking profit of an establishment issuing promises to pay, with the character of a legal tender, to the extent of many millions, against securities bearing interest.

" I cannot but express my entire concurrence with the view of Sir C. Wood. There is no such thing as a *profit* in transactions of this nature, without a corresponding *risk*. The legitimate function of a State is to provide a safe, convenient, and certain form of currency ; and if it goes beyond this, and grasps at the profit of a private Banker, by trading on its credit, and issuing promises to pay, in the hope of being able to redeem those promises by the sale of securities, it incurs a serious liability.

" The utmost vigilance of the most experienced Banks has often failed to secure them against the necessity of stopping payment ; and Banks possess

facilities for strengthening their Reserves, and contracting their Issues, very different from those of a Government."

And again in a minute of June 1861;—

"I dissent *in toto* from the fundamental principle of the original Bill that there is any grand *coup* to be effected by using the influence and authority of the Government to effect a large substitution of paper for silver."

This view was adopted and its adoption involved the rejection of other parts of Mr. Wilson's scheme as explained by Mr. Laing:—

"If, in the then apparently desperate state of Indian finance, a Revenue of £1,000,000 a year could have been derived from a State Paper currency, this possibly might have justified the circle arrangement, though even then I consider it would have been bad policy to sacrifice the future to the present, to the extent of entailing on India an inconvenient currency for the sake of a little temporary relief. The inducement, however, being gone, no doubt could remain on the subject. No one acquainted with India can doubt that the chief advantage looked for from a Paper currency would be lost, if it were not uniform. If a traveller starting from Calcutta for Peshawar had five or six times in the course of his journey to go to a banker or money-dealer and get his notes changed, probably at a discount, for notes of a new circle, it is almost certain that he would prefer taking with him, as at present, a bag of Rupees. In India distances are great; communications imperfect; the Native population generally ignorant and suspicious with regard to monetary matters; and money-changers accustomed to exorbitant rates and anxious to retain their business. To divide India, therefore, into some 40 or 50 different currency circles would have been to create a state of things, like that which, before the general introduction of Gold, existed in Germany, where the original Thaler or Florin of the unhappy traveller soon dwindled down to half its amount in exchanges at the frontiers of a succession of petty States."

* * * * *

"The idea of a large direct profit to the State (beyond that resulting indirectly from facilities to trade and to the Government service), being abandoned, and the principle of issue adopted being one which requires no attempt at self-regulating adjustment by constant sales and purchases of

securities, the necessity for a costly and complicated machinery of semi-independent Commissioners no longer exists."

The foregoing summary explains the origin of the Paper Currency scheme which became law as Act XIX of 1861.

This Act prohibited both private and Presidency Banks from issuing notes. It laid down that the lowest denomination of the new notes should not be less than R10. (The Secretary of State and Mr. Wilson had both pressed for a R5 note.) India was to be divided into three or more circles of issue, each containing one city to be "the place of issue" of the notes of the circle. Three of these circles were to have their "places of issue" at the Presidency towns and to be in the charge of a Head Commissioner (at Calcutta) and two Commissioners (at Madras and Bombay). The other circles were to be in the charge of Deputy Commissioners of Issue subordinate to the corresponding Head Commissioner or Commissioner. Notes could issue either from the headquarters of a circle or from an agency in the circle and were to be payable on demand at either of two places—(a) the office at the head-quarters of the circle of issue, (b) the Paper Currency office at the Presidency town of the Presidency in which the circle of issue was situated. The Head Commissioner, Commissioners, Deputy Commissioner, and Agents were required to issue notes on the tender of current silver coin, standard silver bullion, other notes of the same circle, or, if the Governor General so directed, gold.

Against the notes issued a reserve was to be held by the "Department of Issue" consisting of (a) Government securities in an amount, not exceeding four crores, to be fixed by the Governor General in Council with the consent of the Secretary of State from time to time, (b) coin and bullion of a value equal to the balance of the notes in circulation.

Monthly abstracts of the accounts of the Department were to be published in the Gazettees. Interest on the securities held against the notes was to be credited to General Revenues under a head "Profits of note circulation." Notes were to be legal tender for all payments except by Government at offices and agencies of issue.

Except for certain provisions which will shortly be stated the system thus enacted was entirely independent of banking agency. The reasons which led the Government to dispense with this agency will now be noticed.

There is little on record to show what first suggested the withdrawal of the Banks' right of issue; no doubt it was recognised that the public required a Paper currency system on a broader basis than the note issues of the Banks with their purely* local circulation. Though Mr. Wilson discussed the comparative merits of a Government note system and a Banking system at some length, there was no thought in his mind of retaining the privileges of the three Presidency Banks in any form. He advocated a purely Government system, and the only alternative he saw was a note system managed by a great Central Bank such as the Bank of England.

As will be seen from the following extracts from a minute and a speech in Council he did not reject this alternative because he was in any way averse to the establishment of a "Bank of India" to take the place of the three Presidency Banks; but he considered that there was no necessary connection between banking and the issuing of notes:—

"I desire that this proposal for a sound Paper circulation in India may be considered as a plan altogether apart from and independent of the creation of a large banking corporation, adequate to the requirements of the trade of the country, and through which all the business of the Government may be transacted, as that of the English Government is with the Bank of England. I do not wish that I shall be understood in proposing this plan in any way to close the consideration of the establishment of such a bank, which might in fact represent the banking department of the Bank of England, performing all the functions which that department does towards the Government and the public. From what I have already said, it will be obvious that the creation of a Government issue department will be in no way inconsistent with the establishment of such a banking company."

* * * * *

"The issue of notes does not necessarily constitute any part of the business of a Banker, who is more properly a dealer in capital: a borrower from one

* The Head Commissioner of Paper Currency said in evidence before the Government Paper Currency Commission of 1866:—"I do not remember ever having seen a note of the Bank of Bengal in Upper India."

man and a lender to another upon higher terms, which forms his profit: in short, a most useful and beneficial medium, through which the spare capital of one portion of the community is rendered profitable in the hands of another. We can have no better proof of this than the facts that, notwithstanding the great number of Private and Joint Stock Banks in London, none of them (the Bank of England only excepted) do or ever did issue notes: in Manchester, one of the largest emporiums of trade in the world, not one of the Banks (the Branch of the Bank of England excepted) issues notes; and by the laws of 1844 and 1845, all Banking Companies established after those years within the United Kingdom are distinctly interdicted from issuing notes. We require no further proof that the issue of notes is no necessary part of a Banker's business."

He justified his preference for State agency somewhat as follows:—Under a Government Paper Currency system the whole receipts from the notes could be held in reserve as security for their due payment, and thus an over-issue of the notes could be absolutely prevented. Probably a Bank could not be induced to keep such a reserve, and it would therefore be unsafe to make its issues legal tender. Even if the Bank complied with this requirement, the other creditors of the Bank would have a claim on that reserve; it would be improper to "set aside and earmark" any of the assets of the Bank "for the sole benefit of a particular class of its creditors, the note-holders." Mr. Wilson allowed this defect to be only nominal in the case of the Bank of England, a Bank with an immense capital and already securely established in the public confidence; but he considered it a fatal objection to the management of the Paper currency by a *new* Bank which, whatever its magnitude and "however prudently conducted," would be exposed to "all the early risks attendant upon commercial success."

Moreover, such a Bank, when fully established, could not possess greater credit than the State itself; nor could it employ the immense agency that Government has at its command. "In the great capitals of the Presidencies and in many of the large emporiums of trade little difficulty could arise however the circulation might be conducted, but it is the Government alone that has agencies established in every part of India, however remote. These agencies again are the centres at which "a great bulk of

all the monetary transactions of India takes place: whatever the currency in use it is really constantly passing out of and into the Government Treasuries."

It may be noticed that one of these arguments, at any rate, largely depended for its force on the adoption of Mr. Wilson's particular scheme. When it was intended to establish a large number of circles of issue the fact that the Government had numerous agencies already available, *i.e.*, the public treasuries, was an important consideration. But this intention was abandoned. The number actually established in 1862 was three only, and these being recognized as inadequate were in fact supplemented by the use of Branches of the Presidency Banks as agencies of issue.

This variation of Mr. Wilson's scheme was due to Mr. Laing. For the reasons already stated Mr. Laing had decided to reduce the number of circles of issue contemplated by Mr. Wilson to three circles only, one for each Presidency, though the Act gave the Government power to create a larger number. While thus securing greater uniformity, he was anxious also to give the facilities for conversion, which Mr. Wilson's scheme had offered.

He therefore decided to employ the agency of the Presidency Bank in promoting the circulation of the new issue, and he believed that their assistance would render the multiplication of circles unnecessary. Accordingly Act XIX of 1861 contained provisions empowering the Government "to make such arrangements with any persons, banks, or bodies corporate either at Calcutta, Madras and Bombay, or elsewhere, as may be required, to regulate and facilitate the issue and payment of the notes," and to establish in any circle of issue "agencies of issue in connection with a bank, or otherwise."

Similarly by a separate Act (No. XXIV of 1861) the Presidency Banks were authorized to enter into agreements with the Secretary of State "for superintending, managing and becoming agents for the issue, payment and exchange of promissory notes of the Government of India, and for the carrying on the business of an agency of issue."

Mr. Laing thus defended the course he was led to adopt:—

“The Government of India kept steadily in view, as the main end to be attained, the uniformity of the currency in each of the three Presidencies.

“For this purpose, it was obviously necessary to employ Banking agency. If the State undertook the sole business of the currency without intermediate agency, it was placed in this alternative. It could scarcely make its notes a legal tender at Delhi or Lahore without any provision for cashing them nearer than Calcutta. On the other hand, if it undertook to cash the Government notes at places like Lahore, as the Government could not risk committing an act of bankruptcy, it must either abandon the uniform issue or make provision at 30 or 40 different local centres for every note that might by possibility be presented, including the whole Calcutta issue.

“This, in fact, was the consideration which had driven Mr. Wilson to adopt the system of circles.

“The only escape from it is to have one circle of issue only in the Presidency, and one place, *viz.*, Calcutta, where coin can be demanded from Government for notes as a matter of legal right, but to make arrangements with Banks by which the means of cashing notes are practically provided for every man within a convenient distance.

“Banks being accustomed to commercial transactions can, without difficulty, apportion their cash reserves at different points to the practical demand, and make arrangements in case of difficulty in a way that no Government can do. In the extreme case also of a Bank being obliged to postpone for a day or two, until it can receive a remittance from Calcutta, the accommodation of cashing notes which is afforded to the public as a matter of convenience and not of legal right, the consequences are far less serious, than if the Government had failed in fulfilling a legal obligation.

“With Banks, therefore, accessible, who undertake to cash Government notes under all ordinary circumstances; with the surplus local Treasury balances available in case of need to support the Banks in fulfilling this obligation, until cash for the notes can be forwarded from Calcutta; and with every Treasury open to receive notes at par in payment of Revenue, there can be no objection to extending the Calcutta circle of issue over the whole of the Presidency.”

Elsewhere he alludes to the great convenience of such an arrangement:—

“The Banks undertake the whole of what may be called the retail work of issuing and cashing notes across the counter and for small amounts; the whole correspondence as to notes lost or stopped payment; the whole risk of loss from forgeries, etc.; and, what is the most important of all, they

undertake to establish branches wherever desired by the Government, and to provide at them, at their own risk and cost, the means of cashing all Government notes which may be presented in the ordinary course of business."

The first agreements for the employment of the Banks as currency agents came into effect from 1st March 1862.

They constituted the Banks agencies of issue under Act XIX of 1861, and made it compulsory on them to issue and cash Government notes at their Head Office in the same way as the Department of Issue, the office of which it was proposed to locate on the Bank premises. The Banks were to be remunerated for the currency business transacted by a commission of $\frac{3}{4}$ per cent per annum "on the daily average amount of Government currency notes outstanding and in circulation through the agency of the Bank."

The following declaration was appended to the agreement with the Bank of Bengal:—

"Any persons who prefer applying at the mint for notes in exchange for coin or bullion may apply there instead of at the office or agency at the Bank, provided they apply for not less than R2,000 at a time."

Thus, except for the limited option here allowed, the Bank was almost completely identified with the Department of Issue.

Similar agreements were entered upon for the transaction of currency work at the Branches of the Bank of Bengal all of which were in the Calcutta circle of issue. But the obligation to cash the notes on demand was not made absolute in the case of the branches, the words of the agreement being as follows:—

"That the said Branch Bank, during the continuance of these presents, shall and will, to the utmost of their power, pay and satisfy, on demand, to the holders, the amount of all Government currency notes duly issued within the circle of Calcutta under the said Act, XIX of 1861, which shall be presented for payment or conversion into cash at the office of the Bank."

These arrangements were concluded without the previous approval of the Secretary of State, and in the belief that they did not conflict with his previous instructions given in a Despatch of 26th March 1860 discussing Mr. Wilson's proposals. The Secretary of State had then said:—

"It cannot be too generally or too clearly understood that it is the intention of Her Majesty's Government in sanctioning the introduction of a

circulation of Government Paper to keep it entirely and altogether distinct and separate from any Banking operations whatever."

As soon as he heard of the general character of the arrangements contemplated, the Secretary of State repeated this injunction in a Despatch of 2nd May 1861, observing—

"The issue of notes should be quite distinct from any banking establishment; and the supply of notes to any Banks must be on precisely the same footing as to any other person."

He added however :—

"I can quite understand, however, that the notes may be more readily brought into circulation through the medium of bankers, or indeed of other traders, and in a limited sense, therefore, I do not object to the words in the 4th and subsequent clauses, which seem to have been introduced with this view. I object, however, to any banker or trader being, *at any centre of issue*, the only place where coin can be obtained for notes, or notes for coin. Such an arrangement is quite inconsistent with the intention and scope of an Act to provide for a Government Paper circulation in India."

This qualification of the plain prohibition was considered by the Government of India to justify the arrangements they had intended to make with the Banks, and the agreements were concluded and their terms reported to the Secretary of State in a Despatch of 10th February 1862. The Secretary of State replied in a Despatch of 8th April 1862. He objected very strongly to the arrangement made, though agreeing not to disturb it "so far as it had gone." The Government of India sent another explanatory Despatch dated 21st May 1862. In his reply, dated 16th September 1862, the Secretary of State stated his position fully :—

"I did not prohibit, in as many words, the employment of Banks by the Government as the Agents of Issue, because I never supposed that such a deviation from the consistent and uniform view contained in the Despatches from and to India, of the proper course to be taken in this respect, would have been made, before being submitted to me for my opinion and instructions.

"It is, I believe, essential, in order to ensure an adherence to the established principle of issue, that it should not be left in the hands of a Bank.

"The sound principle of issue may be said to have been established before the Committees of the two Houses of Parliament that sat in 1841, and was enforced by the Act of 1844.

"The issue of notes, however, was, from a regard to existing interests and long usage, continued at the Bank of England, though in a separate Department, and subjected to regulations which, if adhered to, would have maintained the recognised principle.

"Twice, however, since 1844 the demands on the Discount Branch of the Banking Department have been such that the Government has been driven to authorise the Bank to depart from the recognised principle of issue, to infringe the legal restriction, and to issue notes beyond the amount which the specie in the Issue Department warranted.

"Such a demand could not have been made on a Department of Government merely exchanging notes for specie and specie for notes.

"The experience thus acquired has shown that the best, if not the only, mode of ensuring adherence to the established principle of issue, is by totally separating the issue from any Banking establishment.

"It was a strong conviction of this that guided Her Majesty's Government in the measures which were sanctioned for establishing a Paper currency in India, where there were no long-established interests or usages in existence. They believed it to be wise to entrust to Government agency, and to Government agency alone, the issue of Paper as well as of metallic money, combining, as far as possible, both measures in the same Department* of Government, and to leave to Banks only the exercise of legitimate Banking functions."

He again insisted on the separation of the Paper Currency Department from all connection with the Banks so far as might be consistent with actual engagements. This would necessitate the reversion to the original plan of circles which, as he pointed out, was already in force in England. "Her Majesty's Government consider it indispensable for the success of this measure that there should exist in certain important places through the country (i.e., elsewhere than in the Presidency towns) the power of demanding coin for notes." But he did not think more than a few very large circles would be required. Finally, he added the remark :—

"It will be for the interest of the Banks to use the notes so as to dispense with the encumbrance of large weights of silver and with that object to obtain them from the Commissioners of Issue and keep them in circulation by cashing them in small amounts."

In other words the Government of India were paying the Banks to do nothing more than what the Banks would naturally

* The Mint.

do without payment "in the exercise of their legitimate Banking functions."

The Government of India of course thought that they had succeeded in doing much more—that, though no absolute obligation had been imposed on the Branch Banks to cash notes at all times and for all amounts, yet the terms of the agreements would practically ensure their doing so. By this time there was a new Finance Member, Sir C. Trevelyan, and his views were not those of Mr. Laing. He pointed out that it was contrary to the interests of the Banks to freely cash notes at their Branches, and that the obligation they had accepted in the matter was not being, and could not be, fulfilled. His remarks may be quoted at some length. They call attention to a point which Mr. Wilson had missed in his statement of the case against a Bank issue:—

"The inexpediency," wrote Sir C. Trevelyan, "of this ill-assorted alliance does not depend upon the existence of commercial derangements. There is an ordinary condition which is decisive against it—the course of the internal exchange.

"Some indication of the action of this current of the internal exchanges upon the Branch Banks in their relation to the Government Paper currency may be gathered from the following passage of the last letter to the Secretary of State:—

"These notes have a private Bank-mark by which they are recognised at the Branches and at the Head Office, those put into circulation by each Branch being freely exchanged for coin at their own Branch, and if sent elsewhere and paid into any other Branch, or into the Head Office, they are immediately returned to the Branch to which they belong, the notes of the Head Office being treated exactly in the same way, except that they are cashed at the Branches more charily, and not if apparently employed solely for purposes of remittance."

"From this it appears that notwithstanding the $\frac{1}{2}$ per cent paid on the whole of the Government Paper currency, to make it 'worth the while of the Bank to maintain considerable cash reserves at a number of Provincial Cities,' the Bank has established subordinate currency circles of its own *within the Calcutta Government Circle*, and that the 'inestimable privilege of an uniform currency' has no existence. Even the notes of the Head Office of the *Calcutta Circle* are 'charily' cashed at the Branch Banks *within the Circle* and are altogether refused 'if apparently employed solely for purposes of remittance.' This may be prudent Banking, but our Government Paper money ought not to be subjected to such treatment at the

hands of our Agents, whom we pay expressly for the purpose of maintaining it in circulation. If our own Agents set the example of refusing to cash our own notes, how can we expect them to be freely taken by the Native Merchants and Bankers, who look upon them with jealousy both as novelties and as interfering with the large profits they have been in the habit of making from the internal exchange. The Bank of Bengal is obviously acting in two incompatible functions, and is under the necessity of doing, in mere self-defence as Banker, what in its capacity of Agent for the Government Paper money does not admit of justification.

“In one case only has the Bank of Bengal attempted to maintain the desired uniformity. It was hoped that the neighbouring Branch Bank of Dacca might be worked in real union with the Head Office at Calcutta. With what result may be seen from the following extract from a Report from the Branch Inspector, dated from Dacca on the 14th instant:—‘The supply of notes received this week are being rapidly absorbed by the Shroffs for remittances in return for advances on salt made in Calcutta. If this circle is to be kept up between Calcutta and Dacca as briskly as heretofore, a tremendous balance in hard cash will be the result.’ Can there be a more decisive proof of the necessity of separating the functions of Bankers from those of Agents for the currency? This useless accumulation of funds at Dacca ought to be stopped, and the Native Merchants ought to be made to pay for the accommodation of enabling them to make their remittances; but this should be done by the Bank in their capacity of Bankers, without its involving a breach of their obligations as Agents for the Government Paper currency. If the hands of the Bank were untied by its ceasing to act as Agent for the currency, it might make large legitimate profits by operating upon the internal exchanges.”

The Report of the Paper Currency Commission published the instructions actually issued by the Head Office of the Bank to its Branches on the question referred to by Sir C. Trevelyan. The instructions of 1862 were to the following effect:—

“The terms of the agreement between the Bank and the Government are that the Bank shall give cash for currency notes to the utmost of its power. This applies to the Branches, and though you will, in the exercise of your discretion, take care to counteract any attempts on the part of the Mahajans to throw the burden of the internal exchange on the Bank and Government, by, for instance, having a large sum of Head Office notes remitted to your station and demanding cash for same at your Branch, in lieu of taking a bill on you from Head Office at the ruling exchange, yet, in every case as a rule you will, as far as you can, give every assistance to promote the circulation.”

Similarly, the Benares Branch was instructed in 1864:—

“Government currency notes of the Bombay and Madras circles should be taken as Inland Bills. When presented in small amounts they may be cashed at par, but the higher denominations, and especially all large amounts (when used to evade the local exchange), should be subjected to a discount, according to the ruling rates of exchange.”

These then were the rules in force while the Bank was paid to do paper currency business. The report also contains the instructions issued after the withdrawal of this business from the Bank. A comparison between the two sets of orders certainly bears out to some extent the Secretary of State's contention that the Government had been paying the Bank for doing only what it would have been willing to do without payment to oblige its constituents.

Sir C. Trevelyan's minute was sent with another despatch to the Secretary of State who thus found the views he had expressed from the first supported by actual experience. The outcome of two further Despatches from him dated the 10th June 1863 and the 4th January 1864 was that new agreements were entered upon with effect from 2nd January 1866. In these agreements the Banks consented to be entirely dissociated from currency business in consideration of receiving compensation calculated at $\frac{3}{4}$ per cent per annum on the value of notes in circulation through their agency at the time the agreements were revised. This compensation was to be paid until 1st March 1867, the date on which the agreements of 1862 would have expired in ordinary course.

The number of circles had been increased in 1864 and some new circles were added after the employment of the Banks as currency agents was discontinued. Some have since been closed, but others have been opened elsewhere, and the existing circles are now eight, namely, those of Calcutta, Madras, Bombay, Rangoon, Allahabad, Lahore, Calicut, and Karachi. The Government is legally bound to give cash for notes only at the office of the circle of issue or at the Currency Office of the corresponding Presidency town; as regards the cashing of notes by officers in other circles the executive instructions lay down that “Foreign notes are cashable only when there is a balance of cash available,”

i.e., when the cash reserve at the time exceeds the difference between the note circulation of the circle at the time and the "fixed minimum circulation." But in the following cases foreign notes to a reasonable amount may be cashed irrespective of the cash balance—

- (a) for *boná fide* travellers on a certificate of receipt.
- (b) „ hotel keepers.
- (c) „ shipping agents.
- (d) „ shopkeepers' agents.

Foreign notes paid on Government account into the Presidency Bank are cashed without restriction.

The later history of the Government paper currency is not directly connected with the Presidency Banks except for an incident which will be mentioned shortly. But, though the point is unconnected with banking, it may be noticed, before leaving the subject of the Paper Currency, that the Government very soon discovered the possibility of facilitating their resource operations by the help of the currency reserve, for we find Sir C. Trevelyan writing as follows in December 1863 :—

"There were seventy-five lakhs of notes in circulation at Madras, and seventy-five lakhs of rupees in deposit. I took thirty-five lakhs of these rupees, and sent them to Bombay (where coined money was much wanted) to reinforce the Government balance there, and re-paid the amount to the Head Commissioner of Currency here, to be credited to Madras as part of the existing currency investment of two crores.

"At Bombay, there were two crores and fifteen lakhs of rupees of notes in circulation, and an equal sum in rupees and bullion in deposit. Of this I withdrew eighty lakhs of bullion, and sent half of it to Madras, and half to Calcutta to be coined, and to be sent back in coin to reinforce the Government balance at Bombay,—equal sums being transferred, as they became due from the Government balance here to the Head Commissioner of Currency to be credited to Bombay as part of the aggregate currency investment of two crores.

* * * * *

"The Government note currency was established merely for the purpose of providing a cheap and convenient currency; but it has now become apparent that it will also be of much public advantage by absorbing the redundant specie when money is plentiful, and giving it out again when money is

scarce. In other words, it will perform for India, from several different centres, the same service which the Bank of England performs for Western Europe."

The propriety of these operations was much questioned at the time by Sir C. Trevelyan's colleagues in the Supreme Council, but Sir Henry Maine held that they were not illegal. The only instance of a real departure from the principle of strictly maintaining the whole currency reserve for its proper purpose of securing the credit of the Government notes occurred in 1865. On the 15th June 1865 Sir B. Frere, the Governor of Bombay, addressed the following telegram to the Viceroy:—

"Severe commercial crisis in Bombay—run on Bank commencing—Bank return of cash and notes lower than safety requires and rapidly diminishing by withdrawing of deposits. Directors state great danger of Bank suspending payment unless immediately supported by Government. May this Government advance to extent of one hundred and fifty lacs from currency reserve if necessary. * * * * Unless you telegraph immediately authority to this Government to act if necessary, it may be too late to avert disaster financial and political more extensive than mere stopping of Bank."

The Government replied as follows on the 16th of June:—

"With reference to your telegram of yesterday, use your discretion. You will be supported. Keep us informed of the progress of affairs."

This assurance enabled the Bank to tide over the crisis without actually drawing upon the currency reserve. The facts were reported by the Government of Bombay to the Secretary of State, who commented on them in the following terms:—

"It is quite clear that if any connection is to be maintained in future between the Government and the Bank of Bombay, effective measures must be taken for guarding against any similar proceedings, and against any call being hereafter made for aid from Government.

"Since the transfer of the Government balances at Bombay to the custody of the Bank, the only monies at the command of the Government are the balances at the other treasuries in your presidency, and they could hardly be of sufficient amount, or be so readily available as to be adequate for giving assistance to the Bank. It follows, therefore, that the only direct and immediate aid which your Government could give would be by applying for such

purpose part of the currency reserve, and it was from this source that you proposed to the Government of India to render aid to the Bank.

"The objections to using any portion of that reserve for any such purpose can be scarcely exaggerated. It would, in the first place, be illegal, and even if this were not the case, the same state of things which led to the pressure on the Bank, might not, improbably, lead to a demand upon the Currency Department for coin for notes, and the means of meeting that demand would have been taken by the advances to the Bank.

"It is impossible to sanction for the future any proceeding which might lead to such a result."

Another run on the Bank occurred in February 1867 in consequence of a rumour that the Government would not renew its agreement with the Bank. It was stopped by the announcement that the agreement had been renewed and that the Government were prepared "to support the Bank to the full extent of their available resources." On this occasion the currency reserve was not mentioned and was possibly not intended. The Banks do not appear to have ever again fallen into such difficulties as to feel compelled to ask for immediate assistance from Government. The proposal has indeed been recently made that resort to the currency reserve should be recognized as a legitimate means of increasing banking resources and relieving the money market. But this is to be distinguished from the use of the reserve as a means of saving a Bank from suspending payment.

CHAPTER VII.

THE EMPLOYMENT OF THE GOVERNMENT BALANCES.

Mention has already been made of the circumstances under which the transaction of certain Government business was entrusted to the Presidency Banks. The Banks were given power to enter into the necessary agreements for the conduct of this business by Act XXIV of 1861. The first agreements so made came into force from the 1st March 1862, simultaneously with the establishment of the Government paper currency. The terms of the agreement with the Bank of Bengal were briefly as follows:—

I. The Bank on its side agreed:—

- (a) to take over at its Head Office the “business of paying and receiving money” on behalf of the Government, previously transacted at the General Treasury, Calcutta, and to transact for the Government “all such business regarding the receipt, collection, payment and remittance of money and securities and other matters as is usually transacted by Bankers for their customers”;
- (b) to act, at its Head Office, as agents of the Government for the issue and circulation of Government notes.

II. The Government in return promised the Bank the following direct remuneration:—

- (a) repayment of the actual cost of packing and shipping specie;
- (b) a grant of ₹43,606 per annum representing the cost of the establishment previously maintained for the work transferred from the General Treasury;
- (c) a commission of $\frac{1}{2}$ per cent per annum “on the daily average amount of Government currency notes outstanding and in circulation through the agency of the Bank.”

III. In addition and by way of indirect remuneration the Government allowed the Bank to make use of the Government balances under certain conditions.

The agreement also provided for the transfer of Government business to the Branches of the Bank. The terms of the Branch agreements were generally similar both as regards the direct and the indirect remuneration.

The agreement was terminable after the expiry of five years.

The agreements with the other Banks were on precisely the same lines.

The principle of these arrangements is obvious. The Banks were to do certain work and be paid for it. The pay was no doubt fixed on a liberal scale, and the work added to their prestige. But the real compensation for the withdrawal of their note issues was the right to use the Government balances. This chapter will deal specially with the conditions which from time to time have been attached to that right. But a brief explanation may first be given of the present position in regard to the work the Banks transact for the Government and the direct payment they receive for it.

The agreements on these points have been frequently revised. The Government have generally taken the position that the remuneration, though obviously liberal, might be continued without reduction if the Banks accepted the new demands or conditions which the Government happened to be suggesting at the time. The Banks have argued that their acquiescence in a number of important limitations in deference to the Government's solicitude for the safety of the public balances entitles them to generous treatment on minor points. There has seldom been any serious difficulty in arriving at a compromise acceptable to both parties, and it may be added that the negotiations have generally been facilitated by the readiness of the Bank of Bengal to take a broad view of the questions submitted to it. The agreements were last revised in 1898, and the new agreements remain in force for ten years. They provide for the conduct of Government Treasury business at the head offices and branches of the Banks. The fixed establishment charge prescribed by the first agree-

ment for the transaction of work at the head offices continues to be paid. The Banks also manage the Public Debt. This class of business was added in 1866, but the remuneration has been varied from time to time. The payment of the actual cost of packing, forwarding and shipping specie still continues. The Banks were very soon relieved of the currency work for reasons which are fully stated elsewhere, and the sole obligation which they now undertake in the matter is that of accepting notes of all circles presented in payment of Government revenue or by the guaranteed railway companies, and of cashing foreign circle notes in small amounts for the convenience of *bona fide* travellers. The Banks of Bengal and Madras also undertake to provide accommodation for currency chests at their branches, an obligation which the Bank of Bombay has not accepted. The Banks also at one time transacted savings bank business on behalf of the Government, but this duty has been transferred to the Post Office Department. No special remuneration is now given for the transaction of Government business at branch offices. The Banks have also received special payment for undertaking unusually onerous duties which were not anticipated when the agreements were framed. Thus the Bank of Bengal was paid a lakh of rupees for the services it rendered in connection with the conversion of the 4 per cent Government loan in 1894, though under the letter of the Agreement it might perhaps have been required to do the work without additional remuneration.

We now return to the question of the use by the Banks of the public balances. The following extracts when read together indicate the extent to which the Government admitted the obligation to compensate the Banks for the withdrawal of the right of issue :—

“The Bank (of Bengal) cannot be admitted to have any claim *as of right* to compensation but they are certainly in a position deserving of much consideration and one in which they may equitably look for all reasonable support on the part of Government.” [Finance Department memorandum of 20th December 1860 to the Bank of Bengal.]

“The average daily circulation of the Bank of Bengal for the years 1856 and 1857 was 150½ lakhs. If on this as the basis of calculation, the maximum and minimum balances for the Bank of Bengal have been fixed at 70

and 50 lakhs, respectively, then the maximum and minimum balances in the case of the Bank of Madras will be 7½ and 5½ lakhs, respectively, 16½ lakhs being its average daily circulation for the two years above mentioned.

“This principle is obviously the right one on which to base the arrangement, as the average actual circulation measures the loss to the Banks from the withdrawal of the privilege which it is proposed partly to meet by giving them cash balances without interest.” [Finance Department letter of 1st April 1861 to the Government of Madras.]

The Banks had in fact a strong equitable claim, but no legal claim, and the Government so far admitted this as to be willing to replace by their own balances a portion of the whole amount of notes withdrawn. There is an air of exactitude about the letter to Madras which implies that the portion to be replaced would be some standard proportion of the circulation and that such a proportion had in fact been fixed in the case of the Bank of Bengal. Practically, however, a purely arbitrary method had been adopted in calculating the limits of 70 and 50 lakhs, and no standard proportion was fixed or thought of. The 50 lakhs included 30 lakhs representing what experience had shown to be about the lowest balance ever held at the General Treasury, and 20 lakhs were added because the Bank of Bengal had usually held that amount of money on behalf of Government even before it was formally constituted the Government Banker. It was recognized that the interest on 50 lakhs even with the addition of the fixed payment of R43,606 per annum fell short of the profits the Bank had obtained from its note circulation, but it was supposed that the difference would be more than made up by the grant of a less restrictive charter and by the fact that the Government balances would often exceed 50 lakhs. The maximum of 70 lakhs was obtained by adding 20 lakhs to the minimum of 50 lakhs, but there was no special reason for the selection of this particular amount. Besides, as will be seen, the maximum limit was not a limit on the amount of Government deposits which the Bank could employ for its own profit; it was only a limit on the amount which it might employ in a particular way. What the Government really gave, then, was new business and greater freedom, not cash compensation.

The amounts fixed for the maximum and minimum limits were varied by later agreements, but it is not of importance to follow up this part of the question. The real difficulty has been in settling what the limits should be held to mean, *i.e.*, what should be the precise rights of the Banks in respect of (i) sums below the minimum limit, (ii) sums between the two limits, and (iii) sums in excess of the maximum limit.

The clauses of the successive agreements which govern the use by the Banks of the Government balances will be found reproduced in Appendix B.

The first agreement, that of 1862, conceded to the Bank* the following privileges in regard to the Government balances:—

- (a) The Bank was allowed the unrestricted use for banking purposes "of all moneys and balances which, but for the agreement, would have been received or held at the General Treasury," up to a limit of 70 lakhs.
- (b) In addition, it was given the option of setting aside the excess over 70 lakhs in a separate strong room ready for production when demanded, or of investing it in Government paper and other authorised securities. The power of investment was subject to the condition that the Bank should be "at all times answerable and accountable to the Government of India for the surplus cash balance for the time being."
- (c) Further, the Government agreed to pay interest on the difference between the actual balance and 50 lakhs whenever the balance fell below that amount.
- (d) Finally, the Bank was permitted to use the balances at branches where Government business was transacted on similar terms, suitable limits being fixed in each case, as in the Head Office agreements.

The terms of the agreements with the other Banks were similar, the maxima and minima being 40 and 30 lakhs in the

* *i.e.*, the Bank of Bengal. The agreement with this Bank will be referred to throughout except where the contrary is stated. The agreements with the other Banks were on the same lines.

case of the Bank of Bombay, and 15 and 10 lakhs in the case of the Bank * of Madras.

In saying that the Banks were permitted to use the Government balances it need scarcely be explained that the whole Government balances are not referred to. The balances meant consist of the sums which, if the Banks did not transact treasury business, would be paid in ordinary course into Government Treasuries at the places where the head offices and branch offices of the Banks are established. But as those places are generally important centres and, in the case of the Presidency towns, are the places at which the Government have to concentrate the bulk of their surplus funds by remittance from the interior, the public deposits which might come into the hands of the Banks as Bankers for Government tend to form a considerable proportion of the Government's whole floating balances.

There are several points to notice in connection with the interpretation of the conditions recited above.

In the first place, the Government practically bound themselves not to divert from the Bank's coffers revenues which, under the old arrangements, would ordinarily have passed through the General Treasury. For example, it would not have been consistent with the spirit, and hardly with the letter, of the agreement to have established a Reserve Treasury.

Again, the Bank naturally exercised the option of investing the surplus balances and drawing dividends. But by so investing the Bank ran the risk of loss on forced sales if Government suddenly demanded more cash than could be safely supplied from the cash reserve.

Next, the Government's right to make such a demand was not prominently and unequivocally asserted. As regards the *surplus* cash balance, *i.e.*, the excess over 70 lakhs, the right might fairly perhaps be held to be implied in the phrase "at all times answerable and accountable." But this phrase did not apply to the first 70 lakhs of Government balances. The right of Government to recall their whole deposits was left to be inferred from the

* The Bank of Madras had successfully protested against the very low limits first proposed, which have been mentioned on pages 81 and 82.

reference to a possible reduction of the balance below 50 lakhs. It was probably in fact intended that the balances should not be substantially reduced below the maximum limit except in case of actual necessity and after reasonable notice.

It was very soon found that this system did not work. The case against it was set out very clearly in a minute by Sir Charles Trevelyan of the 16th December 1863 :—

“ On the 19th of November the Financial Secretary informed the Directors of the Bank of Bengal, by my desire, that it was probable that we should have to draw heavily upon them, and he suggested for their consideration whether it would not be for their advantage to convert into money great part of the 86 lakhs which they had invested in Government securities out of the public balances in their hands. The answer I received was that, rather than sell any portion of the paper held by them on account of the Government, they had determined to sell some of their own Government paper in England; but this was only to the amount of about 12 lakhs, and a limit of price was prescribed which was likely to prevent the sale.

“ On the 10th of December the Financial Secretary informed the Directors that the expectation previously expressed had been realized, and that it was indispensably necessary for them to prepare to meet our drafts by re-converting the greater portion of the 86 lakhs into money. The answer I received will be seen from the following extract from a note from the Financial Secretary of the same date :—

“ I spoke to the Bank Directors to-day on the subject of the sale of the Government securities purchased out of the Government funds. I read to them an extract of your note, saying that the investment of this money was causing serious public embarrassment. They expressed their inability to sell in the present state of the market; they were of opinion that there was not money to buy the paper even at the present rates, and that if forced to sell, the rates they would obtain would be ruinously low. This state of things indubitably establishes the complete failure of the present system. The Directors are doing the best they can to gather up their resources, and to limit their transactions as much as they possibly can.’

“ These 86 lakhs have therefore, for any present purpose, been as completely cut off from the Government balance as if they had never belonged to it. The Directors * would not sell while they could still do so at a gain compared with the prices at which they had bought, and now they could not sell without loss to themselves and a serious aggravation of the disturbed and exhausted state of the money market. In all our calculations of the

* The justice of this charge was disputed.

means at our disposal for meeting the heavy drain upon us from various quarters, we must estimate the public balances at whatever they may be, *wisus* £860,000. But this is far from being all. According to the statement of the affairs of the Bank of Bengal for the week ending the 9th of December, the reserve of the Bank at the head office and branches in notes and specie, to meet Government liabilities to the amount of ₹1,96,78,612 and private liabilities to the amount of ₹1,62,04,040, was only ₹99,81,333.

"The total amount of the Government balance at the head office and its branches was ₹2,96,78,612, but of this, one crore, or ₹1,000,000, was held in reserve in coin on account of the Government; and I have therefore only stated the difference as the liability to the Government.

"The Bank's reserve at the head office at Calcutta amounted only to ₹56,64,853.

"It will be seen from this what very large investments have been made by the Bank from the Government balances, partly in Government securities and partly in its general banking business. Nearly the whole of that portion of the Government balances over which the Bank possessed a control, *i.e.*, ₹1,96,78,612, after deducting the crore set apart as the Government reserve, has been invested—₹86,42,200 in Government securities and ₹1,10,36,168 in the Bank's general banking business.

"The regularity of our financial operations has been already deranged by this state of things. Instead of having at our command the usual ample balance in the principal Treasury of the Supreme Government, which has always heretofore been relied upon as the great reserve in time of need, we have been obliged, even from the commencement of the crisis, to manage and spare that balance."

Returning to the same incident in a later minute Sir G. Trevelyan wrote :—

"A time of pressure in the mercantile and money markets is always likely to be a difficult time for the Government; and in the recent instance we suffered severely from the falling-off of the opium revenue, and other causes. Large funds were required to meet the Secretary of State's Bills at Bombay, and for other purposes, but our reserve had been invested by the Bank of Bengal in Government securities and mercantile discounts. For about eight or ten weeks the anxiety was very serious. There was no deficiency in the balance of income and expenditure. There was no deficiency even in the amount of the cash balances. But the available portion of our cash balances had been neutralised. In order to avoid a greater calamity, I had to manage and spare the Bank of Bengal as I best could until the crisis was passed.

"The Government was also brought by the same process into a very objectionable relation to the mercantile community ; for, notwithstanding the very large amount which had been lent from the Government balances through the medium of the Bank of Bengal to support the trade of Calcutta, yet, as it was necessary for the public safety to point out to the Directors the absolute necessity of increasing their reserve, the pressure upon the money market seemed to come from the Government, and the great difficulty of the Calcutta money market was popularly supposed to be the insufficiency of the Government balance, and demands which the Government made upon it."

This is one of the two instances in which it is definitely on record that a Presidency Bank has felt compelled to ask the Government to restrict their demands on the public deposits. It is probable, however, that there were also occasions on which the Government were warned, informally, through the official Directors, that the Bank should be spared as much as possible.

It may be mentioned here that this question of the efficiency or availability of the public deposits is quite distinct from that of their ultimate safety. On the latter point there has never been reason for anxiety except in the case of the old Bank of Bombay ; and even in that case depositors were repaid in full and the Government lost nothing as a depositor, though it suffered as a shareholder.

The Secretary of State very strongly objected to the arrangement of 1862, under which the Banks acted as agents for the issue of currency notes. Negotiations were therefore opened in 1863 for the revision of the agreements. The Bank of Bengal took the opportunity of suggesting an alternative scheme for regulating the employment of the public balances. This was that the amount of surplus the Bank might invest should be limited to one crore, *i.e.*, that the Bank should be left free to use up to 70 lakhs for banking purposes as before ; the next crore above that might be invested, and any excess over that would be set aside in cash for the exclusive use of Government. The Government on their part were to engage not to call for any part of the amount invested except in case of actual requirement and after reasonable notice.

The proposal is noticeable because it would have practically involved the Government in a definite engagement such as one of the Presidency Banks has recently asked for in connection with

the grant of advances to the Banks from the Reserve Treasury. The money to which such an engagement applied could not be safely regarded as forming an efficient portion of the Government balances. The suggestion was promptly negatived on this ground, the Government observing that "if the public balances are larger than are wanted by a million sterling, that amount ought to be invested for the public benefit." The Secretary of State concurred, and in a despatch of 4th January 1864 formulated an alternative scheme. His instructions were as follows :—

"I have also to desire that the Government balances may not be placed at Calcutta, or in the branch banks, to an amount exceeding what it is necessary to keep there for payments, as I cannot consent to the locking up of these balances in Government securities beyond what is required by the strictest interpretation of the agreement * * * * I will proceed to state the terms which I should be prepared to sanction for a new arrangement.

* * * * *

"The Bank to act as bankers to the Government, on an understanding that a minimum balance shall be kept of £70,00,000, which is to be shown in the Bank accounts as Government balance, and which may be withdrawn by the Government in case of its being actually required for the payment of demands upon it, without any payment to the Bank in consequence of withdrawal. The Bank to use all the Government balance, so far as the Directors may deem prudent, except such portion of it as may be appropriated expressly for payment of dividends, or for any other defined purpose. The Bank to have, nevertheless, the temporary use of such portion of balances also, if not immediately required, subject to the sanction of the Government Directors.

"The Bank to act in the same capacity in the large towns where Banks may be established with the sanction of Government.

"Under such an arrangement the Bank of Bengal would be placed in the same position as the Bank of England in all its banking functions."

The Government were alarmed at the idea of allowing the Banks the absolutely free use of the whole of the Government balances, and forwarded to the Secretary of State a minute by Sir Charles Trevelyan in which an essential difference between the Bank of England and the Bank of Bengal was pointed out. A fret showing the immense magnitude of the operations con-

ducted by the former Bank on behalf of Government, Sir Charles Trevelyan added :—

“ It (the Bank of England) has a capital of 14 million and a rest composed of undivided profits of upwards of three million more.

“ The position of the Bank of Bengal is very different. The proprietors' paid-up capital is only £1,100,000. In 1840 it was only £30,000 less, for it then stood at £1,070,000. But since 1840 the private business of Calcutta has immensely increased ; and the Bank has lately established nine branches from Bangoon to Lucknow, Agra and Nagpur ; and the Government has transferred its business to the Bank, at the head office and the branches. The Bank of Bengal did not make any addition to its capital in consequence of its opening branches at the principal places of trade in Northern India.

“ In order, therefore, to complete the analogy with the Bank of England, the capital stock of the Bank of Bengal must be greatly increased. Its existing capital is totally insufficient to meet the present demands even of the private trade ; and although the Bank profits by the use of the Government balances, it can give no help in return.

“ The advantage which the Bank has derived from so greatly extending its business, not with its own, but the Government capital, may be seen from the fact that the 24,000 shares of the Bank of Bengal, which were at ₹5,950 previously to the existing arrangement with the Government, were at ₹11,300 previously to the late exhausted state of the money market, and are still above ₹9,000.

“ It remains to be seen whether the Bank of Bengal will qualify itself for properly undertaking the transaction of the Government business by increasing its capital in due proportion to that of the Bank of England.”

The Bank of Bengal *did* qualify itself, under what it regarded as pressure from Government, by increasing its capital to 220 lakhs in 1864 ; and as the Secretary of State sent no reply to the despatch forwarding this minute, the Government of India decided to carry out his instructions, with certain modifications to which his sanction was obtained.

The settlement with the Banks was long delayed and the new agreements did not actually come into force till the 2nd January 1866. They contained the following provisions regarding the public balances :—

- (a) The Government undertook to maintain in the hands of the Banks at their head offices an “ average

cash balance" of a specified amount* "so far as the same may conveniently be done."

- (b) The Banks were permitted to use the whole balances for the time being for banking purposes.
- (c) Interest was to be paid by Government when the Government balance at the head offices (including gold, bullion, etc.) fell below a specified minimum amount.†
- (d) The above conditions referred to the balances at the head offices. For the branches no maxima and minima were fixed. The Banks were to be allowed to employ "the whole of the balances (at branches) however large for the time being" for banking purposes, subject to the condition that each branch should "at all times be ready to meet the drafts of the Government" to the extent of the Government balances at the branch, the Government on their side undertaking to warn their officers not to overdraw their accounts.

It will be noticed that the phrase about the "average balance" was almost meaningless. The maximum limits of the first agreements were real limits, for the Banks could not use sums in excess of those limits in ordinary banking operations. But the undertaking to keep an "average" balance could mean little more than that the Government reserved to themselves perfect freedom in drawing on the Banks, or diverting revenue and remittances from the Banks' Treasuries when the balances reached a high point. This seems to be in accordance with the Secretary of State's remark about not keeping an excessive Government balance at the Banks, but it is not quite clear what the Secretary of State himself intended by that remark, for there seems to have been no definite intention at this time of establishing a Government reserve in any form. The practical effect

	Lakhs.			Lakhs.
* Bank of Bengal	. 70		† Bank of Bengal	. 65
Bank of Bombay	. 40		Bank of Bombay	. 35
Bank of Madras	. 35		Bank of Madras	. 20

of these changes in the agreements was that in a few* years the balances accumulated at the Banks as before and the Directors were allowed to use the *whole* balances in any way they liked instead of a portion only.

This agreement and the similar agreement with the Bank of Madras were to remain in force till the 1st March 1874. The Bank of Bombay had demurred to the terms offered, and by the time the agreements with the two other Banks had been settled, its condition was so precarious that the Government finally decided to enter upon an agreement for one year only. On its collapse in 1868 the reconstructed Bank worked provisionally under the one year's agreement for some years.

It was also treated with less confidence in two ways. The defunct Bank had never been allowed to take over treasury work at its branches, and the concession was apparently withheld from the new one till 1871. Moreover, it was required to invest (or set apart) its balances in excess of the "average balance" instead of being allowed to use the whole balances in banking business. This restriction also was withdrawn in 1871.

In the case of the Bank of Bengal the new arrangements worked satisfactorily, partly no doubt owing to the great increase in its capital. We find it stated in 1875 that neither this Bank nor the Bank of Madras had ever given the Government any anxiety as regards the efficiency of the public balances since the breakdown of which Sir Trevelyan wrote in 1863. Probably one cause of this was the change which the agreements of 1866 made in the method of employing the balances. Instead of being locked up in Government securities which might at times be almost unsaleable, they could be used in discounting mercantile bills maturing at short intervals. But difficulties occurred in 1874

* The balances left with the Bank of Bengal were remarkably low during the years 1864 to 1870 for some reason which is unexplained. As the agreements in force during these years contemplated the deposit with the Bank of the whole Government balances, it must be presumed that the Government's working balances were actually depleted throughout this period and not merely withheld.

with the Bank of Bombay which proved that the arrangements with the Banks were still imperfect. What happened is thus described in a note by Mr. R. B. Chapman:—

“In January 1874 the experience of 1863 with the Bank of Bengal was repeated, in an aggravated shape, with the New Bank of Bombay. The general cash balances being at the time about 15 crores, the Government was engaged in a very large expenditure for the operations undertaken to relieve the distress expected from the scarcity in Northern Bengal. The Government balance at the head-quarters of the Bank of Bombay was, at this time, about a crore of rupees. Nevertheless, although all India had known for some time that there was strong pressure upon the Government resources, an intimation that the Government would probably draw upon the New Bank of Bombay for 30 to 35 lakhs produced a telegram from the Government of Bombay to the Viceroy warning the Government of India that it was “placing the Exchange Banks and the trade of Bombay in great danger,” and that if it drew more on the Bank of Bombay, there would be a general panic and serious danger of stoppages.

“The minimum balance which the Government had agreed to keep with the Bombay Bank, on pain of paying interest upon any deficiency, was 25 lakhs. Thus, at a time when the money was urgently wanted, the Government of India was deprived of the use of 75 lakhs of rupees. This temporary insolvency of the Bombay Bank, as regards the Government, was not due, as in the case of the Bengal Bank in 1863, to over-investment in Government securities. The Bank held at the time only about 30 lakhs of Government securities of its own, and it had lent money on other 42½ lakhs. But it had discounted about 140 lakhs of mercantile bills and bills of exchange, and this caused the difficulty. It seems probable that, as with the Bank of Bengal in 1863, so with the Bank of Bombay in 1874 the evil was caused by the insufficiency of the Bank's capital when compared with the Government deposits entrusted to it.”

The revision of the Charter Acts and Agreements was then under discussion in connection with the impending surrender of the Government shares, and it had been proposed to continue to the Banks the right to use the whole Government balances. But the default of the Bank of Bombay led to the reconsideration of this decision. In a minute of 19th June 1874, Lord Northbrook criticized the system then in force as inconvenient to Government, and misleading to the public, and suggested that in future the Banks should have the use of only a portion of the balances, the remainder being separately held by Government as a reserve on which to draw in case of sudden emergency. This reserve was to

be of two crores, "the main difficulty" being "one only of time." These views were communicated to the Secretary of State in a despatch of 30th June 1874 (reprinted in Appendix C).

The Secretary of State (Lord Salisbury) replied in a despatch of 6th May 1875 (reprinted in Appendix C). The despatch is a most interesting review of the questions which had been most keenly discussed in the preceding years. Regarding the danger involved in the financing of commerce by Government he agreed with the Viceroy, observing:—

"Capital supplied by Government, and not representing the savings of the community, is a resource on whose permanence no reliance can be placed, and which therefore tends to lead traders into dangerous commitments. It gives ease for a time, and produces the prosperity which is at the mercy of an accident. A political exigency suddenly withdraws the adventitious resource, and the commerce which trusted to it finds itself pledged beyond what its own resources can make good."

He thought, however, that the end desired could be obtained without any permanent hoarding up of a large sum in a Government Reserve:—

"The object you have in view will be sufficiently attained by freeing yourself from all exceptional liability to the Banks. Your proposal that a minimum balance should be fixed, all deduction from which should carry interest against you, appears to me reasonable. Without such a protection, express or implied, it would be difficult for the Banks to transact business with so large a customer. You would naturally take care to fix a minimum which should not impose any burden upon the State beyond what is necessary for their fair remuneration. Any such arrangement should be supplemented by a corresponding provision that if the balances which you think fit to leave with the Bank exceed a fixed maximum and the Bank should desire to retain them, they should bear interest in your favour. But these agreements would not give to your relations with the Banks any exceptional or even unusual character.

"No further engagement on your side will be necessary. The understanding that all revenue is to pass through the Banks wherever branches exist will not be renewed. You will take care to make it clearly understood that the amount of your deposits is discretionary, and that if it is convenient to you at any time to retain in the treasury the proceeds of the revenue, the Banks possess no right in respect to it that will entitle them to complain.

"In ordinary times you will probably not wish to retain money in the treasury. If apprehension of difficulty is felt, or if the course taken by any Bank indisposes you to trust it with the custody of large deposits, it will be

at your discretion to hold back the growing produce of the revenue in the treasury, instead of paying it over to the Bank. At a very brief notice you will thus be able to accumulate, in your own coffers, the two millions which you judge to be necessary for your security in times of pressure, even if a large portion of it cannot be provided by drawing upon your balances. Any sum so reserved you will deal with according to the exigencies of the time. It will be competent for your Financial Department either to retain it in the treasury, or to lend it for short terms under suitable conditions as to interest and security."

The portion of the despatch just quoted is remarkable as containing the suggestion that the Government might lend not only to the Presidency Banks but also elsewhere. So far as the Presidency Banks were concerned, the Secretary of State's orders involved not a concession but a restriction. Instead of getting the use of the whole Government balances for nothing, they were to pay interest if they wished to use more than a certain limited amount. The proposal was a not unnatural extension of the system already in force. But the suggestion that the Government should enter into the market and do a competing banking business was new. The following comment was made upon it by Mr. R. B. Chapman, the Financial Secretary :—

"These proposals are quite new, and I feel doubtful about them. It may be assumed at once that we should be seldom able with any advantage to lend money in this way in the interior. We might do so, sometimes, at the Presidency towns. But this would involve serious competition with the Presidency Banks, and I should be inclined to lend money, if at all, usually *through them*. Perhaps the purpose of the Secretary of State would be secured by an arrangement with the Banks to lend them sums out of our reserved balance, at our discretion, on short terms, at very easy rates? If the Banks should decline such an arrangement we might reserve the right of lending, always on Government security, and only in large sums, to the Exchange Banks or other named firms. But I am disposed to fear that if the Government enters into competition with the Banks it will inflict upon them a grave injury; and I should prefer not to attempt it. This project, moreover, seems to me to be inconsistent with the policy of the Government of India which intends to prevent all dependence by trade, directly or indirectly, upon the Government balances."

The Government, however, passed no orders at the time on the question of lending to the Presidency Banks or elsewhere, as they preferred to avoid committing themselves in the matter.

The new agreements, which came into force in 1876, were based on this despatch of the Secretary of State. The Government undertook as before to pay interest to the Banks when their balances at the Banks fell below certain minima. They entered into no formal undertaking as regards maxima, but communicated the following intimation of their general intentions:—

“ It is to be understood that the Government will ordinarily not leave with the head-quarters of the Banks, otherwise than temporarily, more than the following sums:—

	Lakhs.
Bank of Bengal	100
„ Madras	30
„ Bombay	50

But this condition will not be inserted in the contract, which will impose no obligation upon the Government to leave any balances whatever with the Banks. . . . The Government will not undertake to give to the Banks the exclusive custody of all the public balances where the Government banks with the Banks.”

To give effect to this policy a Reserve Treasury was established in 1876 at Calcutta in connection with the Currency Office. Into this Reserve the main stream of the revenue was diverted, all treasuries except those at Calcutta being directed to send their remittances to the officer in charge of the Reserve Treasury instead of to the Bank. Similarly, the Mint Master was to send rupees coined at the mint to the Reserve Treasury and not to the Bank. From the reserve so accumulated the officer in charge (“ the Treasurer to the Government of India ” as he was styled) was to “ pay to the Bank of Bengal such amounts as may be necessary to enable the Bank to meet the demands upon the Calcutta Treasury.” The Treasurer was not ordinarily to receive money into the Reserve Treasury, or make payments from it, except in the manner above described. No Reserve Treasuries were established at this time at Madras and Bombay, but it was explained later that the intention was to draw off the superfluous balances at the other Banks to the Reserve Treasury at Calcutta by bills.

Under ordinary circumstances the effect of these orders was to keep the Government balances at the Banks down to the actual

requirements for Government payments, since the payments at the Presidency towns exceed the local receipts. But there might be periods when the receipts largely exceeded the payments immediately due, and the orders just recited were defective in omitting to definitely lay down that if the Government balances at the Banks became excessive, they might be reduced by a transfer from the Banks to the Reserve Treasury. In fact, no such transfer was made till 1878, and it was contended by the Bank of Bengal that "it was one of the understandings on both sides that the Reserve Treasury was not to be supplied by transfers from the Bank."

In 1878, however, a loan of 2½ crores of rupees was raised, and the proceeds, being receipts at Calcutta, were paid into the Bank of Bengal with the result that the Government balance there rose to 268 lakhs or more than 1½ crores in excess of the maximum limit. This was noticed by the Government who observed that the understanding as to the maximum balance should not be allowed to become "a dead letter." The Comptroller General was therefore directed to transfer the excess to the Reserve Treasury unless he had reason to think that the balance would speedily subside owing to heavy disbursements. As regards the future, he was told when a loan was raised "no more of the amount subscribed should remain with the Banks than would raise the public balances at most to the maxima," and generally that the balances at the head offices should not be allowed for more than a short time to exceed the prescribed maxima. It was added that "the Comptroller General would be at liberty, to the extent to which he could conveniently do so, to accommodate the Banks with temporary advances from the Reserve Treasury, provided they were willing to pay interest on such advances at the current rates." This appears to have been the first occasion on which the Government gave any public intimation that they would recognize the grant of advances to the Banks at interest. The permission to lend seems to have been given chiefly because it was apprehended that the absolute withdrawal from the market of funds subscribed for a Government loan might cause serious inconvenience to the public. The orders, however, did not restrict

the grant of loans to this particular case, but were of general application.

The following additional instructions were given in a letter of the 12th September 1878 :—

“The Government have no intention at present of lending the public balances except to the Presidency Banks, which will be the most convenient channel of distributing the funds whenever they may be demanded. No security need be taken from the Presidency Banks for any sums lent to them at interest any more than for the rest of the public balances in their hands.”

At the end of 1879 it was decided to maintain separate Reserve Treasuries at Madras and Bombay, and it was at the same time explained that the Government regarded themselves as under no obligation to keep more than the minimum balances at the two smaller Banks. The orders were : “There is no occasion to maintain the maximum balance at the Bank . . . As a general rule, no more money in excess of the minimum than may reasonably be required to meet demands on behalf of the Government should be kept in the Bank. But funds should not be withdrawn which must probably be replaced in a short time.” Apparently these orders were not specifically applied to the case of the Bank of Bengal, because, as its disbursements constantly exceeded its local receipts (from which, as mentioned above, loan subscriptions had been excluded), there was little danger of the accumulation of a permanently excessive balance in that Bank.

The Bank of Madras appealed against these orders in 1882, and asked to be allowed during the busy season to retain Government balances up to the maximum of 30 lakhs, and as much more as might be wanted on payment of interest. Both requests were negatived in a letter of 13th May 1882, in which it was said that it had never been the intention of Government “that the Government balance held in Presidency Banks in excess of the immediate requirements of the public service should be regulated with a view to providing banking facilities for commerce. The policy of Government is to require trade to find its own capital. . . Government can only look to the exigencies and interests of the public service for the time being. . . . Government cannot

undertake to keep a balance of 30 lakhs with the Bank of Madras at any season of the year or enter into any engagement or pledge itself in any way to lend money to the Bank on payment of interest."

These orders were slightly modified in 1894 by an instruction to the Accountant General, Madras, that the excess of the Government balances at the Bank over the minimum should be removed to the reserve "not at once but only when it had gone up to a higher level for a settled time."

The actual practice at present is to keep with the Banks an amount substantially in excess of the minimum balance. Though there is no definite rule or admitted obligation in the matter, the Comptroller General or Accountant General as the case may be ordinarily makes a transfer from the Reserve to the Bank some time before the minimum is reached.

It is to be noticed that the various orders quoted refer only to the balances at the Head Offices of the Banks. There is no limit on the Government deposits at branch offices. But the latter are held absolutely at call, and in actual practice are removed with the utmost freedom. Even where it is undesirable to withdraw them from the locality where they have been collected, they can be temporarily transferred to the currency reserve and so rendered unavailable for use by the Bank.

The orders of 1882 and 1884 may be said to have completed the third stage in the settlement of the question of the employment of the Government balances. The arrangements of 1876, as interpreted and developed by later orders, differed entirely from those of 1862 and 1866. Till 1876 the money collected by Government at the Presidency towns was all paid into the Banks. The Banks naturally wished to employ it in the interval before it was needed by the Government, and whether they invested the larger portion of it in Government paper as under the agreements of 1862, or employed the whole balances in their ordinary business as under those of 1866, there could be no certainty that it could be released and surrendered when it was wanted. Under the arrangements of 1876 the "growing produce of the revenue" was no longer paid over entirely into the Banks. The local receipts only were

deposited, and the growth of the balances was thus automatically restrained without any direct and inconvenient interference with the Banks' operations. But circumstances might arise in which the balances accruing from the local receipts might be excessive for a prolonged period. The Government therefore went a step further and asserted the right to transfer the excess to their separate reserve. Such interference was of course direct: but it was not necessarily inconvenient, for as soon as the Banks found that the surplus would be immediately and regularly transferred, they ceased to rely on it. In fact, the efficacy of the later arrangements was not entirely due to a difference in their mechanism. The attitude and spirit of the Government were different. In 1862 and 1866 it was felt that the use of the Government balances was not so much a form of remuneration for the transaction of Government business as compensation for the withdrawal of the right of issue. The Government therefore intentionally left with the Banks balances larger than were needed for Government payments, and were reluctant to reduce them. But long before 1876 the Secretary of State had come to the conclusion that the Banks had been sufficiently compensated for the loss of their note issue, and the difficulties which the Government of India had experienced in connection with the Banks' management of the public balances led them to agree in curtailing the privileges they had first granted. The change of attitude is clearly seen from the fact that in 1875 the Secretary of State was able to declare that it would be unnecessary to fix a minimum balance at all were it not that "without such a protection, express or implied, it would be difficult for the Banks to transact business with so large a customer." Such a statement implies that the Government is a mere depositor and under no prior obligation to the Banks. When this position had been definitely assumed, the demands on the Government balances could be more strictly enforced by the Government and were more readily complied with by the Banks.

The question of the amount which the Government would leave with the Banks in ordinary course being thus disposed of, the only point left for settlement was the question of granting

loans to the Presidency Banks. As the orders stood in 1884, the Comptroller General was perfectly free to grant such loans at his discretion. The Government had indeed declined to commit themselves to a definite engagement that loans would invariably be forthcoming when demanded, and it had been suggested (by Sir D. Barbour) that they should not be granted "except at times of exceptional pressure and to prevent a crisis." But no orders to this effect had been communicated to the Comptroller General, and loans were for some time freely given on application by the Banks without reference to the Government.

In 1888 a Government loan was raised of which 2 crores were paid up in Bombay by the date of the first instalment. The Government Balances at the Bank suddenly rose from 77 lakhs on the 6th July to 281 lakhs on the 13th. On the 14th the Accountant General withdrew 140 lakhs to the Reserve Treasury and by the 23rd the balance had been reduced to 75 lakhs, 50 lakhs being the maximum above which the Bank was expected to pay interest in accordance with the understanding previously referred to (page 95). The Bank and the local Chamber of Commerce protested against the withdrawal of the money, but it proved on enquiry that the Bank had been offered and had refused the option of retaining the excess over 70 lakhs on payment of interest at the Bank rate. Again in October the Government offered to make the Bank "a definite loan for a definite period at one per cent under the Bank rate" if money were wanted "to meet a temporary stringency." This offer also was refused, and the Government decided not to offer such terms as regards interest again. The Government finally dealt with the whole case in two letters of the 12th January 1889, addressed to the Chamber and the Bank. With their letter to the Chamber they forwarded a memorandum by Sir James Westland which showed that the floating balances of the Government were kept at the lowest amount consistent with safety and could not to any material extent be placed more freely at the disposal of trade. The final and "deliberate conclusion" of the Government was summed up in their declaration "that any assistance in relief of the money market which may be afforded by means of the Treasury Reserve

can only be made (1)* through the Bank, (2) at its published rate of discount, (3) in relief of temporary stringency." This should be read with the statement contained in the letter of the same date to the Bank that "(4) the Governor General in Council is unable to enter into any agreement or understanding of a general nature with the Bank for lending to it a portion of the Government Balances," and that "(5) the Government is not prepared to make any change in the policy hitherto pursued in dealing with the balances of the public treasury" (*i.e.*, is not prepared to abolish the Reserve Treasuries).

These few sentences contain definite conclusions on all the questions which had been raised by the establishment of Reserve Treasuries and by the Secretary of State's suggestion that the Government might grant loans to the Banks and possibly elsewhere. In one respect, however, the orders given in 1859 were not at first strictly carried out, or at any rate were not very strictly interpreted, for loans were still given to the Banks whenever they were wanted and at times when there was no real stringency. Thus in 1892 a loan of 20 lakhs was given to the Bank of Bengal when the Bank rate was only 4 per cent. On the fact being brought to the notice of the Government of India the Comptroller General was simply told † that it was left to him to determine "whether the circumstances at the time when a Bank asks for a loan are such as to justify the loan." In 1893, however, the Bank of Bombay asked for an assurance that a loan of 50 lakhs would be forthcoming if the Bank should require it. The Secretary of State was finding difficulty at the time in selling Council Bills at the minimum rate he had fixed, and the Comptroller General having regard to this fact and to the general state of the money market refused to give the required assurance. Some discussion ensued, during which the question was complicated by the fact that the Bank granted loans to the Exchange Banks, and so reduced its balances that it became unable to make advances on Government

* The numerals are not in the original.

† The orders here referred to concluded with the sentence "It is assumed that when loans are given the banks are required to deposit security." This was a (possibly unintentional) variation of the orders of 12th September 1878, quoted on page 97.

paper. The Government of India approved the action of the Comptroller General, and thus explained to the Bank the grounds on which the loan had been refused :—

“ The Government of India are of opinion that compliance with the request made on behalf of the Bank would certainly have tended to defeat the policy of the Secretary of State in fixing a minimum rate for Council Bills, that such compliance might, moreover, at one part of the time covered by the communications, have rendered it necessary to ask the Secretary of State to restrict his sales of Telegraphic Transfers, and that the general circumstances did not justify the grant of a loan to the Bank. In confirmation of the first and last of the three reasons just mentioned for refusing the request of the Bank, I am directed to say that the Government of India are informed that the Bank of Bombay was able to, and did, advance in the last week of April nearly 40 lakhs to certain Exchange Banks on 60 days' bills, although that demand could have been met by the purchase of Council Bills or Telegraphic Transfers by the Exchange Banks concerned.”

The same letter also commented on the inability of the Bank to make advances on Government paper :—

“ The Government feel assured that the Directors recognise that the position and privileges of the Presidency Banks impose on them a responsibility to the Government and to the public, never, if it can be avoided, to dispose of their balances in such manner as to render themselves unable to meet the legitimate demands of trade, expressed in requests by traders as distinct from speculators, for advances of ordinary amounts on the security of Government paper. The harmonious working of the relations that exist between the Presidency Banks and the Government depends on this understanding, and if anything occurred to impair it, the Government would have to consider whether they would be justified in continuing to place the public funds at the disposal of the Bank as freely as they now do.”

From this time loans seem to have been made with less freedom. The practice recognized in 1892 seems very different from that described by Sir J. Westland in January 1899 in the following words :—

“ Having thus placed in the hands of the Secretary of State the regulation of the drawing of Council Bills the Government naturally consider themselves precluded from interfering with his operations by advancing money even on interest to the Presidency and other Banks in India. Occasionally but very rarely short loans of the kind are made, but it is only for the relief of temporary difficulties. The last occasion on which a proposal of the kind was made was as follows. In April last the Bank of Bombay

whose rate at the time was 15 per cent asked the Government to advance 25 lakhs to it for a short time" * * * "the Government was on the point of sanctioning the loan when the Bank rate in Calcutta was reduced from 12 to 11 per cent. (April 20th), the price of Government paper rose and exchange fell. The Comptroller General was accordingly instructed that in view of these indications that the stringency in the money market had been materially relaxed, it was considered that a loan to the Bank of Bombay was not at present necessary."

Recent declarations of the Government indicate, however, a return to the general principles laid down in 1869. Loans will be given, if at all, only in periods of real stringency, and no definite engagement can be given that loans will invariably be forthcoming when demanded, but a more liberal definition of the term "stringency" will be applied than that involved in the practice just described. Such, at any rate, appears to be the effect of the latest orders of the Secretary of State contained in his despatch of 4th May 1899, the last paragraph of which may be quoted :—

"It is impossible to prescribe any specific amount which must be retained in the Reserve Treasury or be otherwise at the command of the Comptroller General on short notice, in order to meet, not only the disbursements of your Government in India, but also the probable amount of remittances to England; and it is essential that an adequate provision should be made for these purposes. Subject to this being maintained, I see no objection to your lending to the Presidency Banks, on the security of Government paper, at such rate of interest from time to time and for such periods as you think best. I am inclined to think that the rate should, as a rule, be not below the Bank rate."

It hardly falls within the scope of this memorandum to attempt an examination of the effect on the money market of the various changes which have been considered in this chapter. It has been pointed out (page 60) that the withdrawal of the right of issue in 1862 deprived the Banks of the means of expanding their resources at times of pressure. The Government balances formed for some time a not inadequate substitute for the note issue. But the policy pursued since 1876 and especially in recent years has been to require trade to rely more on its own resources and less on those of the Government. It would be interesting to consider how far this policy (whatever its justification)

has as a matter of fact contributed to the difficulties of the money market in past years. But so many factors enter into the question that it is practically impossible to isolate the effect of the particular forces which are controlled by the Government. Thus in 1864 the Banks increased their capital; from 1867 to 1870 the private deposits held by the Bank of Bengal were abnormally large; in 1893 the mints were closed to the coinage of silver, and so on. However, the following figures showing the fluctuations in the Bank of Bengal's minimum rate of discount will not be without interest though their precise significance must be largely a matter of opinion:—

	Average rate.	Lowest rate.	Highest rate.	Difference between the highest and lowest rates current in any one year.	Average number of changes in the rate in each year.
<i>First period.</i>					
1854—61.					
The last eight years during which the Bank enjoyed the right of issue					
	5-8	3	11	8	7
<i>Second period.</i>					
1862—76.					
Fifteen years during which the whole Government balances were left with the Bank—					
(a) 1862-63 and 1871-76 during which the Government deposits varied from 3 to 4½ crores					
	5-4	3	11	7½	8½
(b) 1864-70 during which the Government deposits varied from 1 to 2 crores					
	6-7	3½	13½	8	8
<i>Third period.</i>					
1877—99.					
Twenty-three years during which a part of the Government balances has been held in Reserve Treasuries—					
(a) 1877-92 during which loans were freely granted from the Reserve Treasuries					
	5-7	2	12	9	11½
(b) 1893-99 during which loans were not freely granted					
	6-0	3	12	9	12

CHAPTER VIII.

EARLY SUGGESTIONS FOR A "BANK OF INDIA."

There have been at least two definite proposals for the establishment of a single "Bank of India" to take the place now filled by the three Presidency Banks, and the incidental references to the subject are numerous; indeed, between 1860 and 1876 the idea never seems to have been entirely out of sight. It was natural that this should be so. The transfer to the Banks of Government business and the deposit with them of the Government balances raised questions which constantly suggested comparisons with the Bank of England, and thus familiarized the Government with the idea of establishing a similar Bank in India. Again, the position which the Bank of Bengal actually attained in this period so closely resembled that of a single State-supported Bank that the transition to the single bank system seemed an easy one. The Bank of Madras had only a quarter of the capital of the Bank of Bengal, and its Presidency was commercially the least important of the three. The old Bank of Bombay had failed, and the success of the new one was not assured for some years. Moreover, the difficulty experienced in exercising supervision through the Bombay Government contrasted unfavourably with the direct and beneficial relations subsisting between the Government of India and the Bengal Bank. The latter Bank alone had been able to render any real service to the Government during this period, and when funds were required in Bombay for the prosecution of the Abyssinian War, the Government appear to have made more use of the Bank of Bengal's Agency at Bombay than of the local Presidency Bank. The services which it rendered to commerce in these times were probably even more important. Finally it possessed in Mr. Dickson, its Secretary and Treasurer, an officer whose unique reputation as a Banker would minimize

the reluctance of the Bombay and Madras shareholders to allow their interests to be controlled from Calcutta.

The issues which the question of a Central Bank now raises are different. The exchange question, so far from being settled, had scarcely become prominent by 1876. At that time an amalgamated Bank would probably have been refused access to London in any form. It is practically certain too that it would not have been given the control of the paper currency system. Again, the Banks were still enjoying the almost unrestricted use of the Government balances, and they had ample capital of their own, or so at least they would have contended. The Bank of Bengal had recently raised its capital from one crore to 220 lakhs at the instance of the Government and complained, for many years, that it had no means of employing it. The Bank of Bombay on its own initiative had raised its capital from half a crore to two crores, but tempted by the possession of * "more money than it could safely invest," it had embarked on speculative business, and had lost nearly the whole of it.

The earlier references to this question are therefore of more academic than practical interest. They do indeed show that a project for the amalgamation of the three Banks would probably meet with much opposition from Bombay, for the suggestion was actually made in 1867 under circumstances which appeared to promise it a favourable reception, and fell through because of that opposition. But the possibility of such opposition could have been anticipated without the assistance of precedent.

It is curious to find that the terms of a proposal made more than sixty years ago are remarkably appropriate to present conditions. At that time the Banks of Bombay and Madras had not been created, and the operations of the Bank of Bengal were still confined to Calcutta and its neighbourhood. In 1836 "a large body of merchants interested in the East Indies" submitted to the Court of Directors a project for a "Great Banking Establish-

* Report of Sir C. Jackson's Commission. The deposits as well as the capital were probably a source of temptation, and with a capital of less than two crores a heavy loss might have fallen on the depositors in addition to the loss which actually fell on the shareholders.

ment for British India." The promoters were of opinion that a single State Bank "confining its transactions strictly to Banking principles and business," and "established by Act of Parliament and possessed of adequate capital, would, under judicious management and control, become an instrument of general good by facilitating the employment of a portion of the redundant capital of this country (England) for the general improvement of Indian commerce, giving stability to the monetary system of India, and preventing those occasional fluctuations to which it is at present subject, and also by affording the Company facilities and advantages in their future financial arrangements."

These views were re-stated at length in a "Prospectus" which is remarkable for its omission of almost all the practical details of the proposed arrangement. It stated, however, that the functions of the projected Bank would include the transaction of the public business at a moderate charge, and the payment of interest on the Public Debt. It was also to "facilitate the receipt of the revenue and its subsequent diffusion through the various channels of the public expenditure, furnish the remittance to Great Britain of the sums required there for the Home charges, and enable the East India Company to act up to the intention of the Legislature by keeping their Government entirely aloof from that interference with the commerce of India which the present system of remittance involves."

"At present," the prospectus went on, "the basis of the Bank of Bengal is too narrow for such a customer as the Government, and the Bank and the Government being one, the period of the emergency of the Government is the time of the distress of the Bank also: but establish a Bank of adequate dimensions, and its solid capital and extensive credit would enable it to render important pecuniary assistance to the Government."

The Directors of the Bank of Bengal were asked to express their opinion on the scheme, and did so at some length. After alluding to the absence of practical details and observing that the only thing offered to their consideration was "the idea or rather the abstract proposition that concentration of management

might be advantageous," they went on to consider "the proposition whether it will be for the interest of the Bank of Bengal to fall into this scheme and to give up the present advantageous position and prospects in order to unite with an establishment of such infinitely vaster pretension." This position, they thought, was "not to be resigned on the mere exhibition of a scheme of vaster design in which the existing Bank is allowed a subordinate place." Their conclusion was that the Bank of Bengal, as then constituted, was already "sufficiently extensive for any objects they could then contemplate as proper for such an establishment to be engaged in," and if new objects were to be added requiring fresh capital, they "doubted not that the community of the Presidency had the means and would have the desire to make the addition." In particular, they were ready at once to take over the management of Government business, and some of the Directors favoured the establishment of branches at Madras and Bombay, though others preferred the institution of independent Banks at those places. In short, they considered themselves quite able, as they were also willing, to carry out any necessary extension of Banking facilities in India without interference or assistance from London.

This reply was endorsed by the Proprietors at a general meeting, and the proposal seems to have then been dropped.

The next reference to a "Bank of India" is Mr. Wilson's remark quoted * elsewhere, that such a Bank, if established, ought not necessarily to be given the control of the Paper Currency, banking and note-issuing being entirely distinct functions. Mention has also been made of the opinion expressed by Mr. Wilson that a Bank on the lines of the Bank of England might, when once firmly established, be entrusted with the Paper Currency so far as mere safety was concerned. Though on other grounds he preferred to keep the note-issue in the hands of Government, he explained in Council that he was not averse to the establishment of a Central Bank:—

"Before I conclude, there are three subjects of a somewhat kindred character to which I would wish shortly to refer. The first has reference to a

* See extract from a Minute of 1860 quoted on page 66.

question which has been much discussed by capitalists in England, as well as in India. I refer to the proposals which have been made for the purpose of establishing, upon a large scale, and with an adequate capital, a national Banking establishment, capable of gradually embracing the great Banking operations in India, and of extending its Branches to the interior trading cities, as opportunity might offer. That there is a growing want for such an institution and a rapidly increasing field for its operations, no one can doubt. The Government is, therefore, desirous to be understood that the plan which has been adopted for the introduction of a legal tender Paper Currency is not intended in any way to discourage, or to interfere with, such a project, the operations of which would be those of legitimate Banking transactions in India, and exchange operations "abroad."

His successor, Mr. Laing, desired to maintain a closer relation between the Government and the Presidency Banks in the matter of Paper Currency. The following extract from a minute of 7th May 1862 written by him may be quoted, though his remarks do not bear specially on the question of a single Bank:—

"I am convinced that a connection with a State Bank, like that which exists between the Government and the Bank of England, is a great mutual advantage. The convenience to the State in ordinary times is obvious, and history shows what an important resource a Bank may be to the Government in times of difficulty. The advantages to commerce, though less obvious, are not less real. It may be true that the Directors of the Bank of England have committed errors before the working of the Foreign Exchanges was so well understood, and close theorists may argue that a State should hold itself entirely aloof from any connection with Banks and commerce. But practical men come to very different conclusions. They know that, while a State depends for its revenue on the prosperity of commerce, and while by the magnitude of its receipts, payments, and deposits, it, of necessity, affects monetary transactions, it is more purism to say that it will hold itself entirely aloof from them. Practically, a nation whose commerce is largely developed must employ credit largely, and this credit is based upon reserves. Is it better that the great central reserve should be in a Bank, like the Bank of England, with resources greater than any private establishment, and bound by its traditions and its connection with the Government to avoid speculation and to confine itself to safe and legitimate business; or that there should be no

* This is doubtful. At the time Mr. Wilson spoke, the Secretary of State's views on the question of the Banks undertaking Foreign Exchange business were apparently not fully known.

central reserve and nothing between the country and a panic but the separate reserve of private Bankers and Bill-brokers, who act without any concert and with every inducement in quiet times to run their reserves low and make the most of their credit ?

“ This is a question which history also answers, and no one, who has compared the commercial experience of France or England for the last 20 years with that of the United States since President Jackson from political motives severed the connection of the Government with the United States Bank, will hesitate to say that a State Bank is a great protection against both the frequency, the intensity, and the duration of commercial panics. With these views I should, without hesitation, have recommended the Government to place the Banks of Bengal, Bombay, and Madras avowedly on the footing of State Banks, but I refrained from doing so because I was aware that the Secretary of State held different opinions.”

Mr. Laing was succeeded by Sir Charles Trevelyan, who was apparently the first to direct attention to the insufficiency of banking capital in India. His comparison between the capital of the Bank of England and that of the Bank of Bengal has already been quoted (page 89). In accordance with his suggestion, and with the approval of the Secretary of State, the Bank raised its capital to 220 lakhs in 1864, after it had stood at a little over a crore for some 25 years. The result was a fall in the dividends, and complaints were still made eight or nine years later that the Bank's capital could not be fully employed. Thus in a letter of the 9th August 1872 it was said:—“ the advances to the public are now to the extent of only 40 lakhs more than the amount of the capital, while the deposits from the Government and the public exceed 7 crores, of which there is thus only the 40 lakhs employed.” This argument scarcely gives sufficient weight to the consideration that a Bank's capital is to be regarded largely as a guarantee for its liabilities to its depositors. Moreover, the aggregate of the public and private deposits was abnormally high from 1871 to 1873 and subsequently declined considerably. The Government of India on their side could point to the facts that the Bank of Bengal after increasing its capital never again failed to meet demands on the Government balances, and that on the capital so increased the Bank always earned a reasonable dividend.

The Bank of Bengal so strengthened completely overshadowed the Bombay Bank. The difference in the status of the two Banks is well brought out in a minute written by Sir Bartle Frere in 1866 :—

“ The Government of India is directly connected with the management of the Bank of Bengal, one of the three Government Banks in India. This is not only the Government Bank of the vast Bengal Presidency, but it is the Bank which is most intimately connected with the Financial Department of the Government of India, and which transacts all the banking work connected with State Loans and the general Financial operations of the Indian Government.

“ The Bank of Bombay, on the other hand, as far as Government is concerned, deals only with local interests ; till very lately, its capital was much inferior to that of the Bank of Bengal, and without comparing the management of the two Banks, there is no doubt that for some years past the Bank of Bengal has enjoyed unusual advantages in the very able management of its present Secretary, Mr. George Dickson.

“ It is a very serious disadvantage that the Government Bank of Bombay is not only junior in point of age and commercial standing, but that it is subject to a multiplicity of masters to an extent which seems to me utterly inconsistent with sound banking management.

“ Besides the Local Government the Bank of Bombay is subject to the distant and not always friendly criticisms of more than one Department of the Government of India. The relations of that Government with the Bank of Bengal are necessarily direct and intimate. The criticism which emanates from the Financial Department of the Government of India at Calcutta, or the Government of India itself when at Simla, must often take its colour from what is in some respects a rival banking institution.

“ Moreover, the criticism reaches the Bank of Bombay through a variety of channels. It may come through the Local Government, or through the Accountant General, or Currency Commissioner, both of whom are in direct correspondence both with the Government of India in the Financial Department and with the Account and Currency Departments.

“ It seems very desirable, as far as Government is concerned, that the question of an amalgamation of the Government Banks should be seriously entertained with a view to ascertain whether there is any insuperable difficulty in amalgamation. It is obviously quite impossible that the Government of India should go on much longer with three Banks of which one is in intimate confidential direct relation with the Government of India, but has no direct control over banking operations in the great mart of Western

India, while another Bank, placed in a position of influence in a large, rapidly increasing, and sensitive money market like Bombay, has no direct communication at all with the Government of India, but is subjected to indirect influences sometimes through Departments directly under the Government of India, at other times through the Local Government, and generally more or less affected by rival views and interests.

"Probably before this question of amalgamating the Government Banks can be decided, the Government of India will be in a better position than at present to judge whether the head-quarter office of any single amalgamated Government Bank should be the East or West of the Peninsula, but this is a question of much less importance than that the banking operations of Government shall be conducted on a uniform plan through one uniform channel and with but one Government Bank."

As might have been expected, the Government of India refused to take up the question of the amalgamation of the three Banks on a statement which so completely ignored the real causes of the disasters of the Bank of Bombay. The friction of which the Governor of Bombay complained had arisen from the attitude adopted by his Government and not from any difficulty inherent in the exercise of a dual control by the Supreme and the Local Governments. The question was, however, again raised not many months after by the Bank of Bengal.

With a letter of the 19th March 1867 Mr. Dickson submitted to the Government of India detailed * proposals for the amalgamation of the three Banks. His own Bank had important interests in Bombay which could no longer be safely left in the hands of the local Bank. The alternatives before the Directors were the establishment of an Agency or Branch at Bombay and the amalgamation of their own and the Bombay Bank, the Madras Bank being thrown in if possible. The Directors decided "to consider the question in its broader aspect with the view of conciliating and conserving not only existing interests but of establishing one great Central Bank for all India by abolishing the distinctive names of the several Banks and so merging them all into one under a new charter and a new name."

The plan of the Directors was to call up 80 lakhs of additional capital for their own Bank at a premium of 25 per cent

* Reproduced in Appendix D.

(the shares then stood at 75 per cent premium), thus increasing their capital by 80 lakhs and their reserve fund by 20 lakhs (the produce of the premium). Similarly the Madras Bank, the shares of which stood at a premium of 50 per cent, was to call up 44 lakhs on the same terms.

The Bengal and Madras Banks were to be continued as going concerns. But the actual position of the Bombay Bank was very uncertain, and it was, therefore, to go into liquidation. It had recently reduced its capital from two crores to one crore owing to the fact that one crore had admittedly been lost. As a matter of fact, practically the whole of the second crore had been lost also, and though this was not fully known at the time the public had some suspicion of the real state of things, for even after the reduction of the capital to one crore the shares sold at only half their nominal value. Mr. Dickson's proposal was that the persons who had been shareholders in the Bombay Bank should be allowed to take shares in the amalgamated Bank to the nominal value of one crore at 25 per cent premium, the premium of 25 lakhs so obtained being added to the reserve. The result is shown in the following figures (representing lakhs of rupees) :—

	Existing capital.	Existing reserve.	PROPOSED ADDITION		Total proposed capital.	Total proposed reserve.
			to capital.	to reserve.		
Bank of Bengal	220	20	80	20	3,00	40
(Bank of Bombay)	(100)	...	100	25	1,00	25
Bank of Madras	56	4	44	11	1,00	15
TOTAL	5,00	80

The amalgamated Bank would thus have started with a paid-up capital of 5 crores and a reserve fund of 80 lakhs. The nominal capital was to be 10 crores. The Bengal shareholders would contribute the bulk of the capital, and the new Bank would naturally be controlled from Calcutta. On the other hand, the proposal was not disadvantageous to the Madras shareholders whose shares had stood at a lower figure than those of the Bengal Bank and were to be allowed to count as equal in value, share for share. To

the shareholders of the Bombay Bank the proposal was distinctly favourable, for they could come in as so many individuals only, not as a corporation bringing an established connection. But, though their claims might seem to be weak, there were good reasons for conciliating them. They could not bring to the new Bank any business which the Bank of Bengal could not itself obtain without their support, if allowed a free hand. But the doubt was whether the Bank of Bengal would be allowed a free hand in Bombay, except with the consent of the old Bombay shareholders. There was always the possibility that the latter might succeed in reconstructing their Bank, and in that case, if the Government supported them and refused to permit the outside Banks to enter Bombay, they would probably be able to gather up their old connection.

This was in fact what happened. The Directors of the Bombay Bank were in favour of amalgamation but the proposal was carried by only a bare * majority at a preliminary meeting of the Proprietors and was withdrawn by the Bank of Bengal. The Government of India, who had been willing to support any scheme which commended itself to the Bombay community, took shares in a reconstructed Bank and prevented the Bank of Bengal from establishing a regular Branch in Bombay, though they permitted the establishment of an agency with certain limited powers of transacting business.

Mr. Dickson's views on the question of control and on the probability of the Madras Bank joining the scheme are stated in the following extract from his memorandum :—

“ Local Boards would be continued as at present in Bombay and Madras, but the supreme control and the rules and regulations for the conduct of the business must rest in and be laid down by the Board in Calcutta, i.e., the same rules and conditions under which business is carried on here must be strictly adhered to and be conformed to by Bombay and Madras and power to enforce their due observance (must) be specially reserved.

“ Madras may possibly raise objections. I think it would be for the interest of the shareholders of that institution to fall in with the proposal. If, however, they should be of a different opinion their refusal will in no way

* There were 187 votes for amalgamation and 184 against.

affect the carrying out of the proposal as regards Bengal and Bombay. In time Madras must follow."

The following is Mr. Dickson's statement of the advantages which he expected the Government and the public to derive from the fusion of the Banks :—

To recapitulate then : with such a large capital actually provided and liable to further calls in case of need, with an adequate reserve fund in the event of unforeseen losses arising either from the ordinary business or from political disturbances, I submit that the proposed united Bank would be equal, at all times and under all circumstances, not only to meet the legitimate requirements of commerce, but by unity of action, and under the eye of the supreme Government, to control those recurring monetary crises, which, although hitherto more felt in the Bombay Presidency, yet very closely and intimately affect the interest and position of all.

Government would have an absolute guarantee for the unvarying management of their Treasuries under one controlling power ; a certainty of greater economy in the use and distribution of their balances throughout India ; uniform management of the Public Debt under the same safeguards but with enlarged security and a powerful agent in aiding them in all their financial measures, not only at the seat of Government, but by combined action throughout the whole country ; nor do I despair of (what I venture to term) sounder views than those which at present prevail being ere long adopted by Government, and of the management of the Paper Currency being restored to the Bank on terms somewhat similar to those which it formerly enjoyed, or resembling in a modified degree the privileges of the Banks of England and Montreal.

In too many Banks, purely European, the wealthy natives and merchants have of late manifested unmistakable distrust, and it is submitted, with confidence, that, in legislating for India, respect must be paid to their usages, habits, and prejudices. They have never distrusted the Bank of Bengal. Its extension on a perfectly sound and wider basis, combined with a prolongation of the existing happy combination of official and mercantile experience in the Board of Directors, will, it is submitted, tend materially to the progress of India.

The case for the retention of the separate Banks was thus stated in a minute of 12th July 1867 written by the Viceroy :—

"On the question of separate Banks on the one hand and a general Bank for all India on the other, and in particular on that of resuscitating the Bank of Bombay, or allowing an amalgamation with the Bank of Bengal, I am decidedly in favour of the former alternative on public grounds. I see

no such benefit either to the State, or to the community, in the other scheme, should induce the Government of India to support it.

"I submit that it is not for the interest of a State that a great institution of the kind should grow up for all India, the interests of which may in time be opposed to those of the public and whose influence at any rate may overshadow that of the Government itself. A bank of such a character would be very difficult to manage. Few men in India would be found equal to the task. And as regards the interests and convenience of the merchants of Bombay and Madras, surely it is only natural that they should prefer separate Banks for those important centres of commerce. Is it not obvious that, in the course of time, jealousy and ill-feeling will arise if an amalgamated Bank be decided on? Will the control of the Directors of the Bank of Bengal over the Branch Bank in Bombay work so smoothly and effectively as that of a similar body controlling a separate institution for that city? Again, is it not safer for the Government of India to have the cash balances distributed in three Banks, subject at Madras and Bombay to the control of the Local Government in each case, rather than under the general supervision of the Government of India? It appears to me that all these questions ought to be answered in the affirmative."

The Secretary of State's contribution to the discussion was confined to the following remark, written in February 1868 after the proposal for amalgamation had been finally abandoned:—

"Any proposition for changes of a fundamental character, such as the establishment of a central State Bank, or a return to the system of Government Treasuries, which may hereafter be taken into consideration, must be viewed in its general bearings, and not with special reference to the circumstances of a particular Presidency, or of a particular crisis."

Though the question did not again come into the range of practical finance, it has on several subsequent occasions been incidentally referred to. Thus Mr. Ellis, a Member of Council, wrote as follows in 1870:—

"The change which I would advocate as the best is the establishment of one State Bank for India with branches at the presidency towns. I do not by this contemplate the creation of an expanded Bank of Bengal. I am aware that the Financial Department would dread such an institution as likely to become too powerful, and I doubt not with good reason. A real State Bank would be open to no such objection, for it would be presided over by an officer appointed by Government and would be thoroughly under

Government control. I believe the Bank of France would furnish a model which, with suitable modifications, might be adopted for India."

Again, in 1871, the Government of India wrote :—

"We look upon the establishment of a State Bank in India as a matter of great uncertainty, perhaps of impossibility. We should anticipate difficulty in inducing men of commercial ability and experience, as well as of high standing and character, to come to India to manage an institution of such magnitude. Certainly, we have no officer now in our service competent for such duties."

The two extracts last quoted sufficiently indicate the impossibility of deciding the questions of to-day by the opinions expressed thirty years ago.

APPENDICES.

APPENDIX A.

SECTIONS OF THE BANK ACTS RELATING TO BUSINESS.

Act VI of 1839 (Bank of Bengal's Third Charter.)

✓ XXV. And it is hereby enacted, that the said Bank of Bengal shall not be engaged in any kind of business except the kinds of business hereinafter specified, that is to say—

1. The Discounting of Negotiable Securities.
2. The keeping of Cash Accounts.
3. Buying and selling of Bills of Exchange payable in India.
4. The lending of Money on short Loans.
5. The buying and selling of Bullion.
- ✓ 6. The receiving of Deposits.
7. The issuing and circulating of Cash Notes and Bank Post Bills.
8. The selling of Property or Securities deposited in the Bank as security for loans and not redeemed, or of Property or Securities recovered by the Bank in satisfaction of debts and claims.

XXVI. And it is hereby enacted, that the Directors of the said Bank shall discount no Negotiable Security and make no loan unless the amount of cash in possession of the said Bank, and immediately available, shall be equal to at least one-fourth of all the claims against the said Bank, outstanding for the time being and payable on demand.

XXVII. And it is hereby enacted, that the Directors of the said Bank of Bengal shall not discount any Negotiable Securities which shall have a longer period to run than three months, or lend any money for a longer period than three months, and that they shall make no loan or advance on any Bank Share or Certificate of Shares, nor on mortgage, or in any other manner on the security of any lands, houses or immovable property, nor on any Negotiable Security of any individual or partnership firm, which shall not carry on it the several responsibilities of at least two persons or firms unconnected with each other in general partnership, nor be in advance at one and the same time to any individual or partnership firm either by way of discount, loans, or in any other manner (saving by loans upon the deposit of Government Securities, or Goods not perishable as hereinafter mentioned) beyond the amount of three lakhs of Company's Rupees. Provided always that advances upon Bills of Exchange accepted by the Government, or upon other Government Obligations shall not be considered as an advance within the meaning of this restriction.

XXVIII. And it is hereby enacted, that the Directors of the said Bank shall make no loan other than such loans as are described in the Section next preceding, except on deposit of Public Securities to the full amount of the loan, and which Public Securities shall be so endorsed or transferred as to put them at the absolute disposal of the said Bank of Bengal, or on deposit of Goods, not of a perishable nature, and of estimated value exceeding the amount of the loan by at least one-fourth.

XXIX. And it is hereby enacted, that the said Bank shall not be at any time in advance to the Government more than seven lakhs and a half of

Company's Rupees, provided always that the holding of Government Securities or of Bills of Exchange drawn upon the Government, or of other Government Acceptances or Obligations derived to the said Bank from individuals and not overdue shall not be construed as being in advance to the Government within the meaning of this Section.

XXX. And it is hereby enacted, that the Directors of the said Bank of Bengal shall not suffer any person or persons, or body corporate, keeping cash with the said Bank of Bengal, to overdraw his, her or their account.

XXXI. And it is hereby enacted, that the said Bank of Bengal may issue Promissory Notes, payable either on demand or at any date not exceeding thirty days after sight, which Notes shall and may be signed on behalf of the said Bank by such person as the Directors of the said Bank may appoint or authorize in that behalf, provided always that the total amount of such Notes in circulation at any one time shall not exceed two crores of Rupees, and provided also that no such Note shall be for a smaller amount than ten Rupees.

XXXII. And it is hereby enacted, that it shall not be lawful for the said Bank to make, issue or negotiate any Note, Bill or other instrument containing any promise, undertaking or order for the payment of money elsewhere than within the limits of India.

XXXIII. And it is hereby enacted, that it shall be lawful for the Directors of the said Bank of Bengal to receive in deposit Goods not of a perishable kind and to contract for the safe keeping of the same.

Act IV of 1863 (repealing Act VI of 1859).

XXVII. The business of the said Bank of Bengal shall consist in lending on Government Securities and shares in Railways the interest whereon shall have been guaranteed by Government, and on goods, wares, and merchandise not of a perishable kind, in drawing, discounting, buying, and selling Bills of Exchange and other negotiable securities payable in Her Majesty's Indian Territories and not elsewhere; in granting Post Bills payable in Her Majesty's Indian Territories to "order" or otherwise than to "bearer" on demand; in buying and selling gold and silver bullion; in making investments in securities of the Government of India or in loans or bonds secured by the Imperial Parliament on the revenues of India or in debentures of Railways guaranteed by the Government of India; in receiving deposits; in opening cash accounts and credits; in transacting pecuniary agency business on commission; and in selling property or securities deposited in the Bank as security for loans and not redeemed, or property or securities recovered by the Bank in satisfaction of debts and claims.

XXVIII. In addition to drawing, buying and selling Bills of Exchange and granting Post Bills payable in India it shall be lawful for the Bank to draw Bills of Exchange and grant Letters of Credit payable out of India for the use of their Constituents in the Agency Department and to buy Bills of Exchange payable out of India for the purpose of remitting funds to meet such Bills or Letters of Credit.

XXIX. It shall also be lawful for the said Bank through their Directors under any arrangement or agreement with the Governor General of India in Council on behalf of the Secretary of State for India in Council to take over and transact any part of the business of or hitherto carried on at the General

Treasury (or in the Department of the Accountant General at Fort William) and to superintend, manage and become agents for the issue, payment and exchange of Government Currency Notes under Act XIX of 1861 (to provide for a Government Paper Currency) or any Act which may hereafter be passed in relation to the Paper Currency of the Government of India and to pay the amount of such Government Currency Notes in silver to the holders thereof on presentation and demand and the Directors of the said Bank shall have power from time to time to arrange and settle with the Governor General in Council as to the terms of remuneration on which such business in relation to the General Treasury, Accountant General's Department, and Government Paper Currency shall be undertaken by the Bank and also as to the examination and audit from time to time of the accounts and affairs of the Bank on behalf of the Governor General of India in Council.

XXX. The Directors of the said Bank shall not make any loan or advance on shares or consolidated stock of the said Bank, nor on mortgage, or in any other manner on the security of any lands houses or immovable property, or the title-deeds relating thereto.

XXXVI. It shall be lawful for the Directors of the said Bank, with the sanction of the Governor General of India in Council from time to time, to form business agencies and to establish Branch Banks at such places as they may deem advantageous to the interests of the Bank, with full power to the said Directors, to appoint during pleasure such agents, clerks, and servants, and either with or without local Boards of Directors or Management, and under such regulations, restrictions, and conditions, as to them may seem fit, and from time to time to vary such regulations, restrictions, and conditions, and the said Agents and other Officers shall give such security for their good behaviour as the Directors may require, and it shall also be lawful for the Directors, from time to time, under any arrangements or agreements with the Governor General in Council on behalf of the Secretary of State in Council to provide for the conduct and transaction by any such Branch Bank or Banks of any part of the business of or hitherto conducted at the Local Government Treasuries, and for the superintendence, management, and agency of the local issue, payment, and exchange of any Government Currency Notes, provided that such arrangements and all regulations and directions given by the said Directors to the Agents or Managers of such branch Banks, touching the management thereof or the description of business to be undertaken thereby, shall not contain anything inconsistent with, or contrary to the provisions of this Act, or of any Bye-laws, Regulations, or orders which may be in force for the time being under the 40th Section of this Act.

Act XI of 1876 (the Presidency Banks Act, repealing Act IV of 1862).

36. The Bank is authorized to carry on and transact the several kinds of business hereinafter specified (that it is to say):—

- (a) the advancing and lending money, and opening cash credits, upon the security of—
- (1) promissory notes, debentures, stock and other securities of the Government of India, or of the United Kingdom of Great Britain and Ireland;
 - (2) bonds, debentures and annuities charged by the Imperial Parliament on the revenues of India;

- (3) stock or debentures of, or shares in, Railway or other Companies, the interest whereon shall have been guaranteed by the Secretary of State for India in Council;
- (4) debentures or other securities for money issued by, or on behalf of, any municipal body under the authority of any Act of a Legislature established in British India;
- (5) bullion or other goods which, or the documents or title to which, are deposited with, or assigned to, the Bank as security for such advances, loans or credits; and
- (6) accepted bills of exchange and promissory notes indorsed by the payees:

Provided that such advances and loans may be made, if the Directors think fit, to the Secretary of State for India in Council, without any specific security;

- (b) the selling and realization of the proceeds of sale of any such promissory notes, debentures, stock-receipts, bonds, annuities, stock, shares, securities, bullion or goods which, or the documents of title to which, have been deposited with, or assigned to, the Bank as security for such advances, loans or credits, or which are held by the Bank, or over which the Bank is entitled to any lien or charge in respect of any such loan or advance or credit or any debt or claim of the Bank, and which have not been redeemed in due time in accordance with the terms and conditions (if any) of such deposit or assignment;
- (c) the drawing, discounting, buying and selling of bills of exchange and other negotiable securities payable in India, or (in the case of the Bank of Madras) in Ceylon;
- (d) the investing of the funds of the Bank upon any of the securities specified in paragraph (a) of this section, clauses (1), (2), (3) and (4), and converting the same into money when required, and from time to time altering, converting and transposing such investments for or into others of the investments above specified;
- (e) the making, issuing and circulating of bank-post-bills and letters of credit made payable in India, or (in the case of the Bank of Madras) in Ceylon, to order, or otherwise than to the bearer on demand;
- (f) the buying and selling of gold and silver, whether coined or uncoined;
- (g) the receiving of deposits and keeping cash accounts on such terms as may be agreed on;
- (h) the acceptance of the charge and management of plate, jewels, title-deeds or other valuable goods on such terms as may be agreed upon;
- (i) the selling and realizing of all property whether movable or immovable, which may in any way come into the possession of the Bank in satisfaction or part satisfaction of any of its claims;
- (j) the transacting of pecuniary agency business on commission;
- (k) the acting as agent on commission in the transaction of the following kinds of business (namely):—
 - (1) the buying, selling, transferring and taking charge of any securities, or any shares in any public company;

- (2) the receiving of the proceeds, whether principal, interest or dividends, of any securities or shares;
- (3) the remittance of such proceeds at the risk of the principal by public or private bills of exchange, payable either in India or elsewhere;
- (f) the drawing of bills of exchange, and the granting of letters of credit, payable out of India, for the use of principals for the purpose of the remittances mentioned in the last preceding clause of this section;
- (g) the buying, for the purpose of meeting such bills or letters of credit, of bills of exchange payable out of India, at any usance not exceeding six months;
- (h) and, generally, the doing of all such matters and things as may be incidental or subsidiary to the transacting of the various kinds of business hereinbefore specified.
- (i) It shall also be lawful for the Bank under any arrangement or agreement with the Secretary of State for India in Council:—
- (1) to act as banker for, and to pay, receive, collect and remit money, bullion and securities on behalf of the Government;
 - (2) to undertake and transact any other business which the Government may from time to time entrust to the Bank.

And the Directors shall have power from time to time to arrange and settle with the Governor General in Council the terms of remuneration on which such business shall be undertaken by the Bank, and also as to the examination and audit from time to time of the accounts and affairs of the Bank by or on behalf of the Governor General in Council.

37. The Directors shall not transact any kind of banking business other than those above specified, and in particular they shall not make any loan or advance—

- (a) for a longer period than three months; or
- (b) upon the security of stock or shares of the Bank of which they are directors; or
- (c) upon mortgage, or in any other manner upon the security, of any immovable property, or the documents of title relating thereto.
- (d) Nor shall they lend or advance, by discount of bills or otherwise, to any individual or partnership firm [except upon the security mentioned in section thirty-six, paragraph (a), numbers (1) to (5) inclusive], any sums of money exceeding in the whole at any one time such sum as may be prescribed by the by-laws for the time being in force.
- (e) Nor shall they discount or buy, or advance and lend, or open cash-credits on the security of any negotiable instrument of any individual or partnership firm, payable in the town or at the place where it is presented for discount, which does not carry on it the several responsibilities of at least two persons or firms unconnected with each other in general partnership.
- (f) Nor shall they discount or buy, or advance and lend, or open cash-credits on the security of any negotiable security having at the date of the proposed transaction a longer period to run than three months, or if drawn after sight, drawn for a longer period than three months: Provided that, in the case of the Bank of Madras, the Directors may discount negotiable securities payable

in Ceylon having at the date of the transaction a period to run not exceeding four months.

Nothing contained in this Act shall be deemed to prevent the directors from allowing any person who keeps an account with the Bank from withdrawing such account, without security, to the extent of sums not exceeding at any one time two thousand rupees in the whole.

42. It shall be lawful for the Directors to maintain as branches or agencies of the Bank, any branches or agencies of the present Banks, which may be in existence on the first day of May 1876,

and, from time to time, to establish branches or agencies at such places within the Presidency in which the Bank is situate as they deem advantageous to the interest of the Bank,

and, with the previous consent of the Governor General in Council, and subject to such restrictions as to the business to be transacted as he thinks fit in each case to impose (such consent and restrictions being notified in the *Gazette of India*), to establish branches or agencies at such places outside the Presidency in which the Bank is situate, as the directors deem advantageous for the interests of the Bank;

Provided that no agency of the Bank now or hereafter established in Bombay, Calcutta or Madras shall advance, or lend money, or open cash-credits on securities, or receive deposits and keep cash-accounts, or discount bills of exchange drawn and payable in the Presidency in which it is so established,

or shall act as agent on commission, or transact any business except as agent of its principal Bank, or any of its branches or other agencies.

The Directors may discontinue any branch or agency maintained or established under this section.

63. The Directors shall, as soon as may be, make, and may from time to time alter, byelaws regulating the following matters or any of them:—

- (a) the maximum amount which may be advanced or lent by discount of bills, or otherwise, to any individual or partnership, without the security mentioned in section thirty-six, paragraph (a), Nos. (1) to (5) inclusive.

Act V of 1879 (amending Act XI of 1876).

4. In the same* Act, section 36, clause (a), sub-clause (4), after the words "municipal body" the words "or any body of Commissioners for making improvements in any port or of trustees of any port" shall be inserted.

In the same section the words "in the case of the Bank of Madras" shall be omitted in both the places in which they occur.

In the same section after clause (a), the following clause shall be inserted, that is to say, "(a) the borrowing of money in India for the purpose of the Bank's business, and the giving of security for money so borrowed by pledging assets or otherwise."

5. In section 27 of the same Act, for clause (d) the following shall be substituted, that is to say—

- (d) Nor shall they [except upon the security mentioned in section thirty-six, paragraph (a), Nos. 1 to 5 inclusive],

"discount bills for any individual or partnership firm for an amount exceeding in the whole at any time such sum as may be prescribed by the bye-laws for the time being in force, or

"lend or advance in any way to any individual or partnership firm an amount exceeding in the whole at any time such sum as may be so prescribed"

6. In section 63 of the same Act, clause (a), for the words "lent by discount of bills or otherwise to"

Amendment of section 63.

the words "lent to or for which bills may be discounted for" shall be substituted.

Act XX of 1899 (further amending Act XI of 1876).

2. To section 36, clause (a), sub-clause (4), of the Presidency Banks Act, Further amendment of section 36, Act XI, 1876, as amended by section 4 of 1876.

the following shall be added, namely:—

"of the Trustees for the Improvement of the City of Bombay under the authority of the City of Bombay Improvement Act, 1898."

Bombay Act IV of 1898.

APPENDIX B.

CLAUSES OF THE BANK AGREEMENTS RELATING TO THE DISPOSAL OF THE GOVERNMENT BALANCES.

*Agreements of 1862 with the Bank of Bengal.***Head Office.*

4th.—That so long as the average Cash Balance for any month in the hands of the said Bank on the said Government banking account shall not exceed 70 lakhs of rupees, the said Bank shall be at liberty to use and employ such balance, subject to the provisions of their present Charter Act, or any future Act relating to the said Bank, and to appropriate the profits arising from such employment without being charged with any interest in account: And that when and so often as the monthly average of such Cash Balance shall exceed 70 lakhs of rupees, the Directors of the said Bank, for the time being, shall forthwith either set aside such excess or surplus in cash to be kept in reserve in a separate cash-room or place of deposit on account of the said Government of India, or shall, at the option of the Directors of the Bank, invest such excess or surplus on account of the Government of India either in the purchase of Government Securities or Railway Debentures guaranteed by Government, in the name of the Accountant General, or of such other officers as the Government of India shall, from time to time, direct, or in the discount of Government acceptances or other claims against the Government, and so that such surplus shall be withdrawn from employment as part of the general funds of the Bank, and so on from time to time as often

Branches.

5th.—That so long as the average Cash Balance for any month in the hands of the said Branch Bank at shall not exceed the average amount of Rupees two and a half lakhs, the said Branch Bank shall be at liberty to use and employ such Balance subject to the provisions of the Charter Act of the Bank of Bengal or any future Act relating to the said Bank and to appropriate the profit arising from such employment, without being charged with any Interest in account: provided always that it shall be in the power of the Directors of the Bank of Bengal with the sanction of His Excellency the Governor General in Council, to alter, modify, or increase the proportion of the aforesaid Balance to be specially set aside for cashing Notes herein provided.

6th.—That when and so often as the monthly average Cash Balance shall exceed Rupees two and a half lakhs, the Bank of Bengal shall forthwith set aside such excess or surplus in cash, to be kept in a separate reserve, on account and subject to the instructions of the Government of Bengal or shall, at the option of the Directors and at the risk of the Bank, invest such excess or surplus (on account of the Government of Bengal) either in the purchase of Government Securities or Railway Debentures guaranteed by Government in the name of the Collector of the District of or of

* Till 1898 separate agreements were entered upon for the Head Office and the Branches. At the last revision in 1903 the subsidiary agreements for the Branches were incorporated in the Head Office agreements.

Agreements of 1862 with the Bank of Bengal—(continued.)

Head Office.

as an uninvested surplus Cash Balance above 70 lakhs of rupees shall on the taking of the monthly average, appear to be in the hands of the Bank. And the said Bank shall, at all times, be answerable and accountable to the Government of India for the surplus Cash Balance for the time being so set apart or invested, but shall be entitled to draw and apply the interest or dividends arising from such investment, from time to time, to their own use. But when and so often as the Cash Balance in the hands of the said Bank shall, on the taking of the monthly average, appear to have been less than 50 lakhs of rupees, then in addition to the profit which the said Bank may acquire by the employment of such balance, free from the interest as aforesaid, an additional allowance or remuneration by way of compensation shall be made to the Bank by the payment by Government of interest on the difference between the amount of the actual balance of Government and the sum of 50 lakhs, the interest being calculated at the average rate of interest paid by the public on fixed loans during the month.

Branches.

such other officer as the Government of Bengal shall, from time to time, direct or in the discount of Government acceptances or other claims against Government payable at _____, and so that such excess or surplus shall be withdrawn from employment as part of the General Funds of the Bank, and so on, from time to time, as often as an uninvested surplus Cash Balance above Rupees two and a half lakhs, shall on the taking of the monthly average, appear to be in the hands of the Bank, and the said Bank of Bengal shall at all times be answerable and accountable to the Government of Bengal for the surplus Cash Balance for the time being so set apart, or invested at the risk of the Bank as regards realizing the Securities and shall be entitled to draw and apply the interest, dividends, or profits arising from such investments to their own use.

7th.—That when and so often as the Cash Balance in the hands of the Branch Bank at _____ shall, on the taking of the monthly average, appear to have been less than the sum of Rupees one and a half lakhs, then, in addition to the profit which the said Bank may acquire by the employment of such Balance free of interest, an additional allowance or remuneration by way of compensation shall be made to the Bank of Bengal by the payment by Government of interest on the difference between the amount of the actual Balance of Government in the said Branch Bank, exclusive of the proportion specially set aside as a reserve for Notes aforesaid, and the sum of Rupees one and a half lakhs, the interest being calculated at the average rate of interest paid by the Public on fixed loans at the said Branch Bank during the month.

Agreements of 1866 with the Bank of Bengal.

Head Office.

8th.—That from and after the said 2nd day of January 1866, an average cash balance of 70 lakhs of rupees on the Government banking account at Calcutta shall during the continuance of this Agreement be maintained in the hands of the Bank so far as the same conveniently may be done, the whole of which balance the said Bank shall be at liberty to use and employ for its own benefit and profit, subject to the provisions of their present Charter Act, and the said balance which shall from time to time be to the credit of the Government, shall appear in the Books of the said Bank as the Government balances. But in case the Government cash balance in the hands of the said Bank shall on any day after the said 2nd day of January 1866 and previous to the 1st March 1867 be less than 50 lakhs, and if on or after the said 1st day of March 1867 and during the continuance of this Agreement the day's balance shall be less than 45 lakhs of rupees, then and so often as the same shall happen the said Bank shall be entitled to receive from the Secretary of State interest on the difference between the amount of the actual Government cash balance of the day and the respective sums of Rs 50 lakhs and Rs 45 lakhs as the case may be, such interest to be reckoned at the lowest rate charged by the said Bank to the public on the day on which the difference may exist.

Branches.

19th.—That notwithstanding anything to the contrary in any of the said subsidiary Agreements appearing, the Government shall not be bound to keep any minimum balance at any of the said Branch Banks nor to allow the said Bank interest in lieu of keeping such minimum balance; and on the other hand, the said Bank shall be at liberty to employ for its own benefit and profit the whole of the balances, however large for the time being appearing in the accounts of the said several Branch Banks which are now or may hereafter be established as Government balances, provided that the said several Branch Banks shall at all times be ready to meet and shall meet the drafts of the Government of India and Bengal respectively and their respective officers, to the extent of such balances respectively, but subject, however, to the conditions and stipulations contained in despatch No. 3174, dated the 17th day of July 1863, from Edward Harbord Lushington, Esq., the Financial Secretary to the Chief Commissioner of the Central Provinces, and which is to be taken as incorporated in these presents.

Agreements of 1876 with the Bank of Bengal.

Head Office.

8th.—That the Government shall not be bound to deposit or leave at

Branches.

4th.—That the Government shall not be bound to deposit or leave at

Agreements of 1876 with the Bank of Bengal—(continued).

Head Office.

the Principal Office of the said Bank in Calcutta either all the public money for the time being at Calcutta or any minimum sum. But in case the aggregate balances standing in the books of the said Bank in Calcutta at the credit of the Government of India or the Government of Bengal and any officers of these Governments whom the Government of India may at any time in that behalf name shall at the close of any day during the continuance of this Agreement be less than thirty-five lakhs of rupees then the said Bank shall be entitled to receive from the said Secretary of State and shall charge him with interest for such day on the difference between the aggregate amount of such balances and the said sum of thirty-five lakhs of rupees such interest to be reckoned at the lowest rate chargeable on such day by the said Bank to the public for loans recoverable on demand.

Branches.

the branch office of the said Bank at _____ either all the public money for the time being at _____ or any minimum sum.

Agreements of 1886 and 1893 with the Bank of Bengal.

The clauses of the later Agreements relating to the Government balances have been identical with those of the Agreements of 1876.

APPENDIX C.

Papers relating to the establishment of Reserve Treasuries.

No. 256, dated 30th June 1874.

From—The Government of India,

To—H. M.'s Secretary of State for India.

We have postponed consideration of the Bill for the regulation of the Presidency Banks and of the agreements depending upon it, pending receipt of the decision of Your Lordship in Council on the question of the agency of the Bank of Bengal in Bombay, in regard to which we forwarded with our despatch of the 9th January, No. 17, a letter from the Directors of the Bank of Bengal.

2. The strain to which our finances were exposed early this year has given us the advantage of an experience which we had not when the terms of the new agreements were last under our consideration.

3. We have been much impressed with the consideration that the effect of the existing agreements with the banks which compels us to place all the cash balances belonging to Government in their hands leads to consequences which may be very inconvenient, if not worse, both to Government and to trade.

4. The only use of these balances to Government is that they may be made available the moment the public service requires them.

5. We have had no difficulty in regard to the balances in the hands of the Banks of Bengal and Madras; the Bank of Bombay, however, protested against meeting drafts upon it, and on the urgent representations of the Governor of Bombay, we were obliged, on the 29th January, to allow a month's time before drawing.

6. The Bank of Bombay, accustomed to high Government balances, and relying on the maintenance of those balances had so employed them that they were practically locked up; for had we insisted on withdrawing them more suddenly, we should have done so in the face of a warning that we should produce a commercial crisis, and therefore for a time the Government balances at Bombay were useless for the purposes of the Government.

7. We think it doubtful, moreover, whether it is any real advantage to trade that large Government balances should be kept in the hands of the banks. It appears to us that an element of uncertainty is thereby introduced into the money market not unlikely to aggravate commercial difficulties at a time of tightness.

8. An amount of capital which is large relatively to the whole capital engaged in trade at the Presidency towns is supplied by Government; but Government, for reasons quite unconnected with trade, may have to withdraw these balances suddenly.

In this case a sudden demand ensues for capital to replace that which is thus removed; the rate of discount rises, not from any commercial reason, but from the accident of State necessities, and if this should occur at a time of commercial pressure, it would precipitate a crisis which otherwise might not occur. If Government did not supply this capital to the trade, it would be found by private individuals through banks or in some other way.

9. Had the Government funds in the hands of the banks in January last been limited to a fair working balance, and had we had a reserve in our own hands, we think it may be assumed that the market rise in the rates of discount which has occurred would not have taken place, and our business would have been transacted without disturbing trade operations.

10. The resources of a large money market are not open to us, and we do not think it would be safe to trust to being able to raise funds readily and immediately in India. The amount (£350,000) that we wanted in January out of our balance of about a million with the Bank of Bombay, and the demand for which brought down the remonstrance that we should place in jeopardy the trade of Bombay, cannot be considered as large. Calcutta may have larger resources, but we cannot suppose that even here the supplies immediately available are really considerable.

11. We are of opinion that a Government subject to the contingencies to which the Government of India is exposed ought not to be without a reserve, and that this reserve should be in its own hands.

12. This object might be attained by dissolving our connection with the banks and re-establishing our treasuries. We are unwilling to take this course unless forced to do so: the banks are useful institutions, and the Bank of Bengal especially has upon several occasions been of great assistance to the Government.

13. We should prefer, as an alternative plan, to make a change in the agreements with the banks, so that instead of giving them the right to hold all the Government balances, the stipulation may be confined to engaging to pay them interest when our balances are reduced below certain amounts.

If it be necessary to go further than this, we might stipulate that the banks should have the use of our balances up to certain limits, after which we should be unfettered as to their employment. The exact sums to be fixed in connection with the proposed stipulations would be settled in communication with the banks.

14. The amount to be kept in reserve need not, in our opinion, be very large, as the main difficulty is one only of time. The sense of security which we should derive from the possession of a reserve of two millions immediately available for any emergency would, in our judgment, amply repay the charge for interest on that amount.

No. 225, dated 6th May 1875.

From—The Secretary of State for India,

To—The Government of India.

I have considered in Council the following communications from your Government—

Financial letter dated 9th January 1874, No. 17,			
Telegram	"	9th	"
"	"	2nd February	"
Financial letter dated 6th	"	"	No. 41,
"	"	6th	" No. 42,
"	"	13th March	" No. 77,
"	"	24th April	" No. 142,
"	"	30th June	" No. 256,

relative to proposed modifications of the agreements with the Presidency Banks for the conduct of the Government business, and the withdrawal of the Agency of the Bank of Bengal at Bombay.

2. I have also had before me letters from Mr. J. B. Norton dated the 9th March 1874, and from Messrs. Marshman, C.S.I., and E. H. Lushington, on behalf of the shareholders of the Bank of Bengal, dated the 17th of the same month, on the subject of the continuance of the Bank of Bengal's Agency at Bombay. Copies of those letters are forwarded herewith for your information.

3. Your letters Nos. 17, 41, 42, 77 and 142, as well as the telegrams of the 9th January and 7th February 1874, refer to the proceedings of the Agency of the Bank of Bengal at Bombay, and of the New Bank of Bombay.

4. In your letter of the 30th June you state that you "have been much impressed with the consideration that the effect of the existing agreements with the Banks which compels us to place all the cash balances belonging to Government in their hands, leads to consequences which may be very inconvenient, if not worse, both to Government and to trade," and you are of opinion that, having regard to the contingencies to which the Government of India is exposed you ought not to be without a reserve of cash in your own hands. That object, you remark, might be attained by dissolving your connection with the Banks, and re-establishing Government Treasuries; but you "are unwilling to take this course unless forced to do so; the Banks are useful institutions, and the Bank of Bengal especially has, upon several occasions, been of great assistance to the Government."

5. Under the present agreements with the Presidency Banks, in each of which Government is a shareholder, and is now represented on the Boards of those of Bengal and Madras as it was formerly also on that of Bombay, by Directors of its own choosing, Government undertakes, though without penalty for failure, to keep average balances as follows:—

	£
In the Bank of Bengal	700,000
" " Madras	250,000
" " Bombay	400,000

And at the head-quarters of the Banks Government is bound to pay interest whenever its balances fall below the following minima:—

	£
With the Bank of Bengal	450,000
" " Madras	200,000
" " Bombay	250,000

6. Direct payments are also made to the Banks, *vis.*—

	Bengal. R	Madras. R	Bombay. R
1. For General Treasury duties at Head Office (annually)	48,606	12,000	12,240
2. For Savings Banks (all alike), $\frac{1}{4}$ ths per cent on the aggregate balance of deposits at the close of the preceding year, and 8 annas a year upon each active account.			
3. Packing and despatching treasure (all alike)	. Actual charges.		
	R	R	R
4. For public debt, for each crore on the register	3,500	4,000	4,000

Government, moreover, undertakes that the payments that would formerly have been made into the treasuries at Calcutta, Madras, and Bombay, and local treasuries, shall be made into the Presidency Banks and the branches thereof, where established with the sanction of Government, and you* state

* Financial letter from the Government of India, dated the 9th June 1873, No. 231.

that "the entire public balances, however large they may be, at the Branch Banks, are at the disposal of the Banks, which receive no other remuneration for doing the Government business at the branches. The Government is not bound to keep up any minimum balance at any branch, but it undertakes to instruct its officers not only not to overdraw their account at the branches, but always to provide a margin at their credit; and, also, that the balance at any Branch Bank is not to be reduced below what it would be necessary to keep in the Government Treasury at the same place, were there no agreement with the Bank." On the other hand, the Banks are at present restricted both as to the nature and the field of their business.

7. It has been decided that the Government shall cease to hold shares in these Banks, and shall have no part in the Direction. But you propose that the law shall still impose on the Banks certain special restrictions. They are still, as now, to be prohibited from certain hazardous branches of business, and their field of operations is, as at present, to be subject to the consent of the State. On the other hand, you would so far alter the present agreements, that "instead of giving the Banks the right to hold all the Government balances, the stipulation may be confined to engaging to pay them interest whenever our balances are reduced below certain amounts."

8. The connection which has thus existed between the State and the Banks has from time to time been the cause of very serious embarrassment. It has produced a general impression that the State is responsible both for the good conduct and the prosperity of the Banks, and when any of them has been involved in difficulty or danger, there has been a disposition to claim, as of right, assistance, or even indemnity, from the Government of India.

9. The controversy which has arisen between the Bank of Bombay and the Bank of Bengal in a great degree arises out of this misconception. It has been thought wise so far to limit the natural competition between the two Banks as to prohibit either from setting up branches beyond the limits of its own Presidency. This policy, whatever its merit, has been adopted on public grounds. The public balances have formed so large a part of their resources that these might, it was believed, have been endangered, if they had been made the instruments for maintaining an unrestricted competition. But no private rights to Government protection were created by this provision; and it affords no foundation for the claim that the Bank of Bengal shall be compelled, against its own strenuous remonstrances, to employ the Bank of Bombay exclusively as its agent at Bombay.

10. The expectations unfortunately engendered by the close connection existing between the State and the Presidency Banks were the cause of an inconvenience, almost amounting to a public danger, which was experienced by Your Excellency's Government in January of last year, and which is much dwelt upon in the despatches before me. The strain upon your finances arising out of the famine compelled you to draw at that time for 35 lakhs upon the Bank of Bombay. Accustomed to high Government balances, and relying on the maintenance of those balances, the Bank had so employed them that they were practically locked up. You were met by an urgent telegram from the Governor, stating that, if you drew anything from the Bank at that time, you

would cause a general commercial panic; and other remonstrances equally pressing were addressed to you from the Bank of Bombay. The result was, that you were compelled, at a moment of singular pressure, to abandon the proposed draft. Your Excellency has correctly stated that "the Government of India has never undertaken to keep balances with the Presidency Banks for the use of persons engaged in trade, and it would be highly inconvenient to admit that any responsibility attaches to the Government in this respect, or that the Government is called upon to regulate the amount that it will leave in the hands of any of its bankers with reference to any other considerations than the interests of the public service." But from the tone of the appeals addressed to you, it is evident that this conception of Your Excellency's duties had in fact arisen in the public mind, and was doubtless due to the relation which had existed between the State and the Presidency Banks.

11. But the tendency to form extravagant expectations upon this connection is more remarkably exemplified in the claims which have been, and up to this day are still, urged upon the Government by the shareholders of the former Bank of Bombay. In that Bank the Government held shares, and as a shareholder, contributed three Directors to the Board of Management. The Bank was regulated by a legislative charter of incorporation, similar in kind to that which Your Excellency is preparing to grant to its successor. The Government Directors were not always capable, and the charter, whilst it imposed some restrictions, omitted others to which the other Banks had been subjected. These two considerations were sufficient, when the Bank in 1866 was ruined by mismanagement, to persuade the shareholders that they had a genuine claim against the Government for compensation. Further reflection has not diminished its value in their eyes, for up to the present year they have not ceased to urge it. That Government should, in consequence of its relations with the Banks, have become liable, in the eyes of an intelligent body of men, to such a demand is a circumstance not to be overlooked in considering the form which these relations in the future are to assume.

12. It was inevitable, from the nature of the connexion between the State and the Banks, that difficulties of this character should occur; and it is probable that under existing arrangements they may occur not unfrequently. The State possesses power greater than any individual, and it is liable to pressure from which individuals are free. A shareholder who can, without absurdity, be asked to indemnify other shareholders for the errors into which the Directors who represent them all have fallen; a customer who contracts to deposit all his balances at the Bank, and who can be reproached as acting unreasonably if he desires to use them when money is scarce—is evidently more valuable to a Bank than ordinary shareholders and customers; and if pressure be necessary to enforce these requests it will probably be applied. In the same way, an external power which can be called upon to prohibit a competitor from encroaching on the markets enjoyed by his rival, possesses a jurisdiction which is too useful not to be frequently invoked. The Banks cannot in any degree be blamed for profiting by the relations into which the State has voluntarily entered. They press naturally for such concessions, and the Government cannot refuse them without incurring odium, or grant them without great embarrassment.

13. The time has come when Her Majesty's Government must consider how far these relations shall continue. Originally they were probably devised to provide banking facilities for the commerce of the country, which it would have been otherwise unable to procure. The development of trade has lessened

the agency of this reason; and I agree with Your Excellency in the doubts you express as to the real value of artificial facilities which arise from large Government balances with the Banks. Capital supplied by Government, and not representing the savings of the community, is a resource on whose permanence no reliance can be placed, and which therefore tends to lead traders into dangerous commitments. It gives ease for a time, and produces a prosperity which is at the mercy of an accident. A political exigency suddenly withdraws the adventitious resource, and the commerce which trusted to it finds itself pledged beyond what its own resources can make good.

14. In your despatch of the 30th June, Your Excellency has intimated a desire to keep a reserve of two millions in bullion in your hands; and you express the opinion that "the sense of security which you would derive from the possession of such a reserve immediately available for any emergency, would in your judgment amply repay the charge for interest on that amount." I recognise the serious danger to which the want of such a reserve exposes you in emergencies. But the emergencies happen so rarely, that I should reluctantly consent to sacrifice interest to the extent of £80,000 a year permanently to meet them.

15. The object you have in view will be sufficiently attained by freeing yourself from all exceptional liability to the Banks. Your proposal that a minimum balance should be fixed, all deduction from which should carry interest against you, appears to me to be reasonable. Without such a protection, express or implied, it would be difficult for the Banks to transact business with so large a customer. You would naturally take care to fix a minimum which should not impose any burden upon the State beyond what is necessary for their fair remuneration. Any such arrangement should be supplemented by a corresponding provision, that if the balances which you think fit to leave with the Bank exceed a fixed maximum, and the Bank should desire to retain them, they should bear interest in your favour. But these agreements would not give to your relation with the Banks any exceptional or even unusual character.

16. No further engagement on your side will be necessary. The understanding that all revenue is to pass through the Banks wherever branches exist will not be renewed. You will take care to make it clearly understood that the amount of your deposits is discretionary, and that if it is convenient to you at any time to retain in the Treasury the proceeds of the revenue, the Banks possess no right in respect to it that will entitle them to complain.

17. In ordinary times you will probably not wish to retain money in the Treasury. If any apprehension of difficulty is felt, or if the course taken by any Bank indisposes you to trust it with the custody of large deposits, it will be at your discretion to hold back the growing produce of the revenue in the Treasury, instead of paying it over to the Bank. At a very brief notice you will thus be able to accumulate, in your own coffers, the two millions which you judge to be necessary for your security in times of pressure, even if a large portion of it cannot be provided by drawing upon your balances. Any sum so reserved you will deal with according to the exigencies of the time. It will be competent for your Financial Department either to retain it in the Treasury or to lend it for short terms under suitable conditions as to interest and security.

18. The engagement which the Banks on their side should be asked to undertake will be only those to which they would probably by preference

submit. If you incorporate them by special legislation, you may properly insert into the Act the restrictions which do not injure their commerce but increase the confidence they enjoy. They should be required to abstain from the hazardous business of foreign exchanges, and from lending on any but the most approved securities. A weekly statement, such as that which is issued by the Bank of England, together with a weekly classification of the securities on which they have advanced, should be supplied by a responsible officer, who should be bound to a true statement under penalty. You will at the same time require such confidential returns as may be necessary to place Your Excellency in full possession of all the requisite information with respect to the distribution of the resources of the Banks and the character of their operations. If the information furnished by these returns is sufficiently detailed, it will not be necessary to reserve a power of inspection, which might impose upon you in the public view an undue responsibility for the management of the Banks, and would, in other respects, place the Government in a false position towards them.

19. These restrictions are no more than you may rightly exact as a condition of the position of advantage in which the Banks are placed by receiving Acts of Incorporation, and by their connexion with your Government.

20. The charter of incorporation will, as heretofore, assign to each Bank the limits within which it may lawfully establish branches. This provision is earnestly valued by the smaller Banks, and is not resisted by the Bank of Bengal. It is open to many and serious objections upon general grounds; but it is agreeable to a practice which has long prevailed, and to abandon it would be to make a superfluous addition to the important changes which the exigency of the case makes it necessary at this juncture to adopt. For these reasons the condition may be reimposed.

21. The demand of the Directors of the Bank of Bombay, that the Bank of Bengal shall be compelled to employ them as agents, stands upon a different footing. The condition has not been imposed before, and it is strenuously resisted by the Bank of Bengal. The acquiescence of that Bank could not be obtained except at the price of some special privilege in fiscal matters, which in effect could only be provided at the cost of the Indian tax-payers. No public advantage could be shown in favour of such an arrangement, and the experience of last year furnishes a new argument against it of much cogency. I should, therefore, not approve of any provisions being inserted in the Bill to disturb the existing state of things in that respect.

APPENDIX D.

PAPER RELATING TO A PROPOSAL FOR THE AMALGAMATION OF THE PRESIDENCY BANKS IN 1867.

Memorandum, dated 1st March 1867, regarding the amalgamation of the Presidency Banks submitted to the Directors of the Bank of Bengal by Mr. Dickson, the Secretary and Treasurer, and forwarded by the Directors to the Government of India.

GENTLEMEN,—Relative to letter of 27th ultimo from the Honourable David Cowie, with enclosure from Mr. Rustomjee Jamssetjee Jeejeebhoy, urging the establishment of a Branch of this Bank in Bombay, I have now the honour, in conformity with your directions, to embody in this form the memorandum which I submitted as part of your yesterday's proceedings.

The extension of the Bank's operations to the Bombay Presidency, which is now urged for adoption, in consequence of the untoward position of the Bank of Bombay, must be viewed in two aspects :

First.—In the aspect of opening a Branch in Bombay, and confining operations to the city alone, together with the probable effect of such action by the Bank of Bengal on the position of the Bank of Bombay and the interest of its shareholders.

Second.—In the broader aspect of fusing the three Presidency Banks and creating one great Bank for India, with the active control in Calcutta, in the sense of its being the seat of the Supreme Government.

Assuming, by reason of the embarrassed position of the Bank of Bombay, that it is not equal to meet the monetary requirements of that Presidency, and that you should resolve to occupy the field in consequence, the first question to be solved is whether, under the existing Charter, it is competent to do so.

By the 36th section it is declared that it shall be lawful for the Directors, with the sanction of the Governor General in Council from time to time to form business agencies and to establish Branch Banks "at such places as they may deem advantageous to the interest of the Bank." [*N.B.*—Confirmed by Mr. Advocate-General Cowie when case submitted regarding Bank of Bombay opening at Jubbulpore and Nagpore.] It, moreover, provides for the conduct and transaction by such Branches of the business of the Local Government Treasuries, as well as for the management of the Paper Currency at present in abeyance.

By section 6 power is given to call up capital to the extent of three crores in all or 80 lakhs in addition to the amount already paid.

Thus then it is apparent that the occupancy of Bombay is not only competent, but that, under the existing Charter, you can provide the necessary capital.

I am, however, clearly of opinion that such action on the part of this Bank would infallibly end in the total collapse of the Bank of Bombay. Its

connection with Government is limited to one year, and as public confidence is undeniably gone, I fear that there exists no probable hope of extrication from their present embarrassments, but almost the certainty of a tedious and costly wind up, should these relations be terminated on the expiry of the year. Meanwhile their ordinary business would be filtered away to the Bank's Agency or other Banking Institutions in Bombay. To the shareholders such a result would inevitably be disastrous. I say so with all the more confidence and freedom, because it is too well-known that the value of their remaining capital depends, to a large extent, on the realization of the assets of insolvent estates, while the liability for impending calls on the shares of joint-stock companies, held in the Bank's name or in the names of its accredited officers, is not yet, I believe, clearly defined, nor ascertained with exactitude.

With such complications before you, I submit that it is more expedient to consider the question in its broader and more extended aspect, with the view of conciliating and conserving not only existing interests but of establishing one great Central Bank for all India by abolishing the distinctive names of the several Banks, and so merging them all into one under a new Charter and a new name. Before, however, discussing this alternative measure, and seeing that immediate action has become necessary, I submit for consideration that the Bank of Bombay should be approached with a proposal to the effect that, pending the maturing of legislation in connection with a new charter, a provisional agreement be entered into between the two Banks, by which certain privileges should be conceded to the shareholders of the Bank of Bombay, immediately and prospectively, on the same footing as those to be enjoyed by the shareholders of the Banks of Bengal and Madras.

Should the proposal be entertained, and the field left open, in an amicable spirit I submit that the Bank of Bengal should immediately call up the remaining portion of its capital and allot the whole, rateably, among its own shareholders at a premium of 25 per cent, *i.e.*, rating each share of Rs1,000 at Rs1,250 or the full share of Rs4,000 at Rs5,000; thus, according to the present market rate, giving a bonus or surplus on the single share of Rs500 and Rs2,000 on the full share. This effected, a whole crore is placed at your disposal for taking up the business of the Bank of Bombay in that city at least. Meanwhile the remnant Branches [*N.B.*—Nine branches withdrawn], eleven in number, could be dealt with according to circumstances by being carried on along with the addition of the Treasury business (never yet conceded to them by Government) should the disclosure of the position, progress, and future prospects of each warrant their prolonged existence.

The present premises in Bombay, at Kurrachee, and the other Branches might be taken over, either on the valuation of parties mutually chosen or on lease. Sufficient accommodation would be reserved for affording every facility for the realization of their outstanding assets by the Bank of Bombay.

On such realization being effected, or at fixed and progressive dates, I would propose under the agreement to allot to the shareholders of the Bank of Bombay for the time being a crore (nearly their existing capital, which is given at 10½ lakhs.) of capital at the same rate as that charged to the Proprietors of this Bank on the call of 80 lakhs, *viz.*, 25 per cent premium. That is to say, for 125 lakhs, they will receive it at present prices 175 lakhs of marketable stock. Nor is it too much, I apprehend, to assume that the proposal now made, if carried out in its integrity, with the sanction of Government, will greatly enhance existing prices. I think a limit of Rs2,000 for each single share may reasonably be calculated on. Thus then the two

Banks, when so united, would have a paid-up capital of four crores and a reserve fund of nearly sixty-five lakhs, a sum, in my judgment, by no means excessive, nor larger than what the Bank so constituted ought to hold in relation to its paid-up Capital, so as to provide for possible and unforeseen contingencies.

There remains, then, only the Bank of Madras to be dealt with. It is not necessary that any great pressure should be brought to bear upon them towards forming a junction with the United Bank. They might, however, have it in their option to do so on conditions of all but equality with the Bank of Bengal, seeing that the market value of their stock stands relatively to our own as 150 to 175. Provision has been made under their new Charter to extend their capital from fifty-six lakhs to one crore. This being so, and in contemplation of their business being extended to Ceylon, it is probable that the full amount permissible will ere long be called up. Assuming such to be the case, and bearing in mind that the capital of the United Bank otherwise is four crores, with a reserve of, say, sixty-five lakhs, the fair and rateable proportion which Madras ought to contribute to the Reserve Fund, along with transfer of guaranteed assets, may fairly be taken at fifteen lakhs, thus bringing up the total Capital to five crores, and the Reserve Fund to eighty lakhs. A moment's reflection will show that this proposal is both equitable and reasonable. If the additional capital of forty-four lakhs is called up and divided among shareholders of the Bank of Madras on the same terms as those on which the Bank proposes to allot the eighty lakhs to our own Proprietors, then they realise eleven lakhs, which added to their existing reserve of, say, five lakhs, gives them sixteen lakhs, or one lakh more than the rateable amount proposed to be contributed to the common Reserve Fund.

Into details of management or minor conditions on which the business of the then United Bank should be carried on, it is not necessary to enter at present. One or two points may, however, be shortly noticed.

The nominal capital under the new Charter should be 10 crores, one-half being paid up.

Local Boards would be continued as at present in Bombay and Madras, but the supreme control and the rules and regulations for the conduct of the business must rest in, and be laid down by, the Board in Calcutta, i.e., that the same rules and conditions under which business is carried on here must be strictly adhered to and be conformed to by Bombay and Madras, and that power to enforce their due observance be specially reserved.

As already observed, Madras may possibly raise objections. I think it would be for the interest of the shareholders of that institution to fall in with the proposal. If, however, they should be of a different opinion, their refusal will in no way affect the carrying out of the proposal as regards Bengal and Bombay. In time Madras must follow.

There are only two points then in the proposed fusion of the Banks on which for a moment I dwell, and to which I deem it necessary to call your special attention.

In dealing with the Bank of Bombay, I stipulate, as the radical and indispensable condition of union or absorption, that this Bank takes over from them nothing but cash, towards payment of its quota of capital, at such periods as they themselves may elect. Their deposits and legitimate business will follow as a matter of course.

In carrying through negotiations with the Bank of Madras, on the other hand, I not only propose to take over capital, but also their entire existing

business, exclusive of past due or irregular advances on simple guarantee of the Bank itself.

Should Bombay decline these overtures, which I scarcely think they will do, then of course it remains with Government and yourselves to consider whether it is desirable or politic that the present chronic state of distrust and embarrassment should any longer be tolerated on the other side.

If Government and the Directors should in the last resort resolve to comply with the wishes of a friendly section of the Bombay community, I will be prepared to carry out your instructions, and on very short notice organise a competent staff to commence operations by opening a Branch in Bombay.

Having thus dealt with the more practical portion of the question in both its aspects as set forth in the early portion of this minute, I deem it necessary in continuation to advert as shortly as possible to its consideration in a public point of view, and why it humbly appears to me that, in the interests of Government, the Bank, and the public, it is desirable to have one strong Bank for India. First of all, however, it may be well to state that we have at home a class of political economists who hold the theory that, in currency and banking legislation, it is sounder policy so to frame the laws as to encourage the distribution of the banking reserves of a country among several Banks, instead of holding them in a single Bank. It is not improbable that some people, reasoning by analogy and holding in principle similar views, may propound them in India, while others, who care little about the principle, will, from interested and factious considerations, join again, as they have done before, in decriing the Bank.

The question of rival establishments first assumed a practical shape in 1865, when a Commission was appointed by the French Government to enquire into the constitution of the Bank of France, and to report whether there should be another and great rival Bank of Issue to that Institution.

The Bank of France, in a stricter sense than the Bank of England, has a monopoly of banking throughout the Empire, and of the paper circulation, which is unrestrained by legislative enactment; and which, moreover, the bank itself issues and is bound to protect.

The Bank of England in like manner issues its own notes and protects their convertibility, but the law defines the proportion of securities and bullion which must be held against the paper circulation and separate the Issue from the Banking Department. But the Bank of England in respect of the legal fetters imposed, and that it pays to Government a large proportion of the profits arising from the paper currency, may in a sense be looked on rather as the agents of Government for doing the retail work connected with the Paper Currency, than the pure issuer of its own notes. Both Banks have not a few exclusive privileges; some of those of the Bank of England are of an enduring nature, while as Bankers to Government their agreement extends to twenty-five years certain. Both Banks are the two great reservoirs in which the banking reserves of both nations are held.

The Commission of the French Government, after taking evidence from the ablest financiers and some of the more notable political economists in France and England, have reported against the proposed creation of another rival bank in that country, and I venture, it may be with great presumption, to doubt if the monied classes, including the representatives of the London and Provincial Banks, will, in 1867, gainsay the evidence which they gave in 1848 and 1858 in favour of the constitution of the Bank of England so far at least as the Banking Department is concerned.

The only countries, so far as I know, where there is a semblance of proof to support the theory are America and Canada. As regards the former, I have to remark that prior to 1861 Banking and Currency were entirely free, resulting, as we all know, in great public injury, bad faith, and bankrupt corporations. In 1861 Mr. Chase, the then Secretary of State, succeeded in raising forty-four millions out of the one hundred and nine millions requisites for the financial want of that year. Of the amount so raised, thirty-three millions, or 75 per cent, was taken by the Bank of the Federal States, but they were too poor to continue the process, because both their capital and deposits were perfectly inadequate to the demands of Government. The English market was tried without success, and American capitalists could afford no further assistance. In this dilemma the expedient was fallen upon of practically confiscating the Note circulation of the whole of the Banks; the legal tender, Greenbacks, were forced upon the country, and thus a new loan of a large amount was raised. Of the extraordinary depreciation in the value of the paper and the enhancement of gold measured in Greenbacks which followed I need not remind you, but it yet remains to be seen whether the compulsory measure resorted to in time of war, and which requires the fifty-nine banks to hold their reserves in Notes, not convertible into gold but receivable for taxes, is likely to prove successful or beneficial to the country. The last return quoted by the *Economist* of 25th August last shows that only

£1,700,818 in gold with
£16,168,102 legal tender notes of the State

or a total of £17,868,920 was held against upwards of forty millions of deposits and something over five millions of the note circulation of the Banks, the residue of former issues.

Eschewing the doubtful policy adopted by America, the Government of Canada; although it abolished the privilege of issue enjoyed by the several Banks and took the paper issues into its own hands, yet deemed it fair to afford liberal compensation to the several Banks and entrusted the management of the Paper Currency to the largest Bank in the provinces, *viz.*, the Bank of Montreal, at an annual charge not exceeding one per cent on the average amount actually in circulation. [*N.B.*—Bank of Bengal commission only $\frac{1}{2}$ per cent.]

Unlike the Governments of England, France and Canada, but in some degree pursuing a policy akin to that of America, the Government of India has taken the right of issue as well as the management of the Paper Currency of India to itself.

Assuming then that the theory under review is in itself sound and can be successfully carried into practice by the Government of India, I observe that the separation of Currency from Banking cannot be more complete in any country.

All exclusive privileges have been taken from the Presidency Banks, which are simply Bankers to Government in the same way as they are Bankers to the merchants and local banking institutions in the several Presidencies. There is, however, this important distinction, that under a terminable agreement and certain penalties Government covenants to keep a minimum floating balance at their credit with the several Banks.

Other-wise, and for services performed, the relations of Government with the Banks are intimate, and, I add, are, or ought to be, valuable to both.

In Calcutta—and I assume throughout the Chief Cities in India—the Presidency Banks are the holders of almost the entire reserves of those who keep a banker.

Banking in India is entirely free, and has had of late years, as we all know, a very remarkable development. If, however, we go back a little and trace its rise, progress, and fall, it will be found that, without almost an exception, every European Bank started in this country soon lost its distinctive character of a Bank proper and either became insolvent or found itself established in London as a Bank of Exchange. These Banks have ramified connections with the seaports of India, the Straits, China, Australia, Japan, California, and elsewhere. Most of them have the privilege of a Note circulation beyond the confines of India, and everywhere they more or less cultivate a local banking business.

As a convenience, and on the obvious ground of economy, the Indian Branches, however, choose to keep their cash reserves with the Presidency Banks, and in times of difficulty—I put the matter broadly—they calculate on receiving assistance from their bankers.

Taking then matters as we now find them, the question is raised, Are there in India the materials for enforcing, by legislation, uniformity in the rule under which each Bank must keep its own reserves in Government Notes, and is it desirable or expedient to encourage such legislation?

To obtain uniformity, the law must over-ride the existing charters of those Banks and compel the weekly publication of assets and liabilities, so that the proportion of silver or Government legal tender notes may be assimilated to the amount of advances outstanding. Even if the above difficulty can be got over, I apprehend that the opposition of the Banks would be very formidable. They would be obliged under such a law to throw on the market that large portion of their Reserves which they hold at present in the interest-bearing securities of Government and convert them into legal tender notes which do not bear interest. Neither Government nor the Banks could possibly gain by such a measure. I question indeed if in reality it would not prove futile so long as the Banks can, without let or hindrance, create on comparatively small capitals a very large superstructure of credit by valuing on each other according to their necessities either on demand or at long currencies.

Is it then expedient to hold out sufficient inducements to new institutions to establish themselves in this country, keep their own reserves, and confine their operations exclusively to India in the same way that the Presidency Banks, the Banks of England and France, and in America, restrict their operations?

I think not. All past experience, while banking *has been entirely free*, goes against the theory. Government might indeed sever the existing connection, create a rival establishment, and give to it the restricted use of their balances, but that would simply be a change of Bankers and probably result in the serious weakening of one Bank only to magnify another or rival establishment.

Purely local Bank, with branches throughout the Presidencies, to be really useful and advantageous to the country, must be established and conducted on sound principles. To such Banks the prestige of Government is of the last importance.

You cannot, I submit, institute a fair analogy between England or France or America and India, nor, with safety or advantage, force upon India theoretical legislation in Banking or Currency.

The usages, customs and habits of the people of this country, who are a nation of traffickers in money as well as in the inland exchanges, are opposed to the rapid growth of purely Western customs and institutions. They must ever retain in their own hands, against all competitors, by far the largest portion of the purely Banking operations in India, and legislation cannot possibly reach them. They have sufficient influence, either by active combination or passive inaction, to defeat any movement of the kind, unless indeed they find that it subserves their own interests.

The question appears, then, to be narrowed to this issue—Is it preferable, with a view to the upholding of separate reserves, to continue the three Banks in the respective Presidencies, or to fuse them into one?

The unfortunate position of the Bank of Bombay, apart from all other considerations, renders it, in my opinion, not only preferable, but necessary. The element of uncertainty regarding such a large portion of its assets, the impending liability for heavy calls, the impaired credit and crippled resources of the Bank, and, beyond all, its inability to cope with recurring monetary crises, must, from time to time, bring its position prominently before the public and tend to unpleasant discussions with Government. The reserve of the Bank, with numerous Branches and a capital reduced by nearly one-half, cannot possibly be maintained at the same high range as that under the amalgamated Bank, which provide so much additional Capital specially for Bombay requirements. Nor can Government have perfect freedom in dealing with their balances at Bombay so long as public confidence is wanting in the stability of that Bank as now constituted. The uniformity in administration which must follow on the fusion of the Banks will certainly tend, more than divided action, to maintain public credit and to restore broken confidence by attracting deposits and thereby enlarging the reserves of the Bank.

A multiplicity of Banks beyond the Presidency towns, purely local in their character and in their business, who would be compelled by law to hold a certain amount of reserve proportioned to their advances, is, I repeat, in my opinion not attainable or possible here.

It is a delicate point to insist on, but I add that I do not believe that the Paper Currency can ever have a fair trial in India until the management of it is restored to the Banks. Government began at the wrong end by prematurely appropriating to itself the supposed large profits of an *imperfect circulation*. Accepting it as an accomplished fact, I nevertheless, with much deference, adhere to my frequently recorded opinion that our currency legislation has been wrongly directed, and that it is only through the agency of the banks that a note circulation can ever have a thorough development throughout India.

Banking monopoly is not possible. No Government, so far as the mere banking connection is concerned, stands more loosely towards a State bank than does the Government of India towards the Presidency Banks of India. If Government or the public are aggrieved, if terms more favourable can be obtained by Government at the termination of the short existing agreement, the connection may be at once ended as a matter of course.

To obtain and preserve that connection, the amalgamated bank must necessarily make sacrifices, which, under other circumstances, would be unnecessary. That the connection is now advantageous to Government, the Bank, and the public is admitted, and that it will be much greater under a united Bank is set forth herein.