

A TREATISE
ON
LONG-TERM CREDIT

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BY

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PRABHAKARA PRESS LIMITED, UDIPI, S. INDIA.

P R E F A C E

Fourteen years ago I was looking for a subject for a book. The subject which suddenly occurred to me was long-term credit. Those were the days of the economic depression. Agricultural prices had fallen, and the agriculturists had been hit hard. They could not repay the loans they had borrowed; many could not pay even interest. Everywhere I saw landowners sinking deeper and deeper into pecuniary embarrassment. Many were badly in need of long-term loans; only long-term loans on easy terms could save them. But landowners had great difficulty in obtaining long-term loans. The problem of security was a great problem, for the value of agricultural land had greatly fallen. I discovered many difficulties connected with long-term loans. I saw that the rates of interest on long-term loans were rising just when the short-term rates of interest were falling. Many agriculturists who were in debt did borrow loans for fairly long periods on the security of their land. But they did not understand the nature of long-term credit; they did not bother about repayment, or the method of repayment. They were sure to get into trouble.

I decided to write a treatise on long-term credit. All the important questions relating to

long-term credit were to be stated and treated in it. I began with an inquiry into the nature of long-term credit. This opened up a vast field of study - a field of inexhaustible interest. I discovered things which were capable and worthy of being formulated into general truths.

Is it at all necessary to deal with long-term credit separately? Is it so very different from short-term credit? People seem to think that there is no hard and fast difference between short - and long-term credit. They think (if at all they think about the matter) that the difference between the two forms of credit is one of degree. But I discovered very early that it is really a difference of kind. To borrow an illustration from literature, the difference between long- and short-term credit corresponds to the difference between the novel and the short story. A novel does not differ from a short story in length only. It differs from it in motive, plan and structure. There are fundamental differences between long - and short-term credit. In the following pages I have fully discussed these differences, and their practical bearings. Economists may be aware of these differences, but, so far as I know, they have not laid sufficient emphasis on these.

The book contains an Introduction, eleven chapters, and three Appendices. The Introduction

and the Appendices are an essential part of the book.

In the Introduction I have defined the scope of the term long-term credit. This will give some idea of the scope of the subject treated in the thesis.

In Chapter I, I have described, at considerable length, the nature of long-term credit. People do not have any exact idea of the nature of long-term credit. Some of the points mentioned in this chapter must have certainly occurred to economists and others, but, so far as I am aware, they have not been expressly stated anywhere. I have been able to discover these points by reasoning, and by personal observation. Here and there I have made use of information contained in books, pamphlets, articles, etc. But my conclusions have been arrived at independently.

In Chapter II, I have discussed the various uses of long-term credit. I have been able to discover as many as seven distinct uses of long-term credit. People are vaguely aware of some uses of long-term credit, and they do not know the other uses. Nobody, I think, has stated all the uses of long-term credit in one place. I have discovered the uses of long-term credit mostly by reasoning and personal observation.

In Chapter III, I have said something about interest on long-term loans. I have been greatly

interested by this subject. I have explained the process which determines the rate of interest on long-term loans. Some attempt has been made to trace the changes in the rate of interest on long-term loans and to explain these changes. I have explained the variations in the long-term rate of interest and have shown how laws regulating the rate of interest on long-term loans cannot be easily evaded. The theories set forth in this chapter have been arrived at independently.

In Chapter IV, I have discussed the problems of long-term credit. People interested in long-term credit may be vaguely aware of one or two problems, but the problems of long-term credit have not been fully investigated. I have stated all the problems and have proposed a solution for each of these problems. The ideas are in the main my own, but I have borrowed one or two ideas from others.

Chapters V, VI and VII are devoted to a subject of vital importance- the sources of long-term credit. All the sources of long-term credit are not fully known to people who are interested in this subject. I have described at some length the institutions which are in a position to provide long-term credit, but only incidentally. I have been throughout interested in the principles on

which such institutions are conducted. I have generally confined myself to principles and problems. In the case of a subject like this one has to deal with questions of fact. I have made use of information obtained from certain sources. I have also borrowed a few ideas from others. But almost all the conclusions have been arrived at independently, and my treatment of the subject is entirely original.

Long-term credit and insurance,- this is the subject treated in Chapter VIII. The man who has not made a special study of the subject is never aware of the fact that long-term credit has much to do with insurance. Long-term credit is related to insurance in at least four different ways. The ideas set forth in this chapter are not wholly original; but they have been for the first time brought together and treated in one place.

In the next chapter I have discussed the place of co-operation in any system of long-term credit. This is a subject of practical interest, especially as credit co-operation has made very great progress in our country. In discussing the place of co-operation in any system of long-term credit, I have described the organization and working of certain credit institutions which provide long-term loans. The conclusions have been arrived at

independently. But I have been to a certain extent guided by the opinions of others.

In Chapter X, I have stated the essentials of a sound system of long-term credit. We have yet to build up a sound system of long-term credit. I have, therefore, thought it worth while to find out the principles on which our system of long-term credit ought to be based. The suggestions contained in this chapter are my own.

I have come to certain conclusions after a careful and prolonged study of long-term credit. These conclusions have been stated in the last chapter. This is not a mere summing-up. I have examined afresh, in the light of the facts and the theories I have been able to discover in the course of my study, the nature of long-term credit, the problems relating to the supply of long-term credit and certain other matters pertaining to long-term credit.

Although my treatise is not wholly original (no treatise can be wholly original), most of the ideas and theories contained in this treatise are my own. For the most part, I had to rely on myself. I could not obviously read up the subject in books. So far as I am aware, no book or monograph has been written on long-term credit. Some of my theories and ideas may appear commonplace. Mr. Jules Romains says

somewhere that Psychology hitherto has merely contrived to say laboriously and obscurely what we all know already. I hope what Mr. Jules Romain says of Psychology is not true of any portions of my work. Some of my ideas may seem obvious, but they seem obvious only when they are pointed out. But I have had to borrow some ideas. The source is indicated in each case. I have also made use of certain ideas and theories which have been current for a long time. I have not cited authorities in these cases. These ideas and theories are known to all those who have some knowledge of Economics. But the fact that it has not been necessary to cite authorities has been in each case indicated by some appropriate expression.

My treatise is not a factual study; it is discursive rather than descriptive. There are many references to existing conditions, but these are just examples.

But no man who writes a book on any economic subject can ignore facts; he must have facts to work upon. I have had to collect a large number of facts. So I have used many books, especially books dealing with economic conditions in India. In many cases I have not gone very deep; I have been content to use standard books. But I have relied only on statements for which

the authors have been able to cite authorities. In a great many cases, however, I have utilized original sources. I have studied reports of commissions and committees, memoranda, prospectuses of credit institutions, annual reports of such institutions, Acts passed by the Central and Provincial Governments, and so on. I have cited authorities whenever and wherever necessary. But not all the information has been obtained from the sources indicated above. I have tried to rely on myself, as far as possible. I have studied at first hand the working of certain systems of long-term credit (for example, that system under which long-term loans are supplied by private individuals) and the working of certain credit institutions like Chit Funds; I have investigated changes in the rate of interest on long-term loans. A very large number of statements made in this treatise are based on personal observation and original investigations. If the source of information is not mentioned, it is to be understood that I have discovered the fact or facts by personal observation.

This treatise on long-term credit has been written with special reference to India. This could hardly be helped. Economic truths are not absolute, but relative to the conditions existing in a particular place at a particular time.

In this treatise I have tried to analyse the ideas relating to long-term credit, and to reduce these ideas into a system. I have divided the subject into different topics, and I have included topics which have not occurred to people before. So far as I am aware no similar analysis has before been explicitly set out.

Throughout I have taken care to see that the treatise does not lose itself in details. I have tried to produce a compact and coherent treatise containing a *connected* account of the more important facts relating to long-term credit.

The subject of long-term credit will assume greater importance when the uses of this form of credit are fully known. Our system of long-term credit is in a rudimentary state. A knowledge of the various uses of long-term credit, of the nature, the problems and the sources of long-term credit will help us to organize our system of long-term credit on proper lines. I venture to hope that this little treatise will be of practical service to persons and institutions interested in long-term credit.

A part of this book (Chapter VIII and the first section in Chapter IV) was originally published as an article in the Journal of the Bombay University dated July, 1946. I have to thank the Publication Board of the Bombay University

for giving me permission to reprint the article.

I wish to acknowledge my indebtedness to all those men and institutions who have helped me in the preparation of this treatise. Many thanks are due to the Prabhakara Press Limited, Udipi, for their co-operation and for the care with which the book has been printed.

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May, 1948.

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INTRODUCTION

In this treatise, I have tried to give a connected account of all the facts relating to long-term credit. But certain things implied by the term long-term credit may not be treated in this treatise. It is, therefore, necessary to define the scope of the term, as it is used here.

The term long-term credit may be held to include the long-term debts borrowed by a Government. It is a well-known fact that Governments often resort to long-term loans. But such loans do not really come under long-term credit, as it is commonly understood. In the first place, the loans are raised by issuing stock. A man who invests his money in Government stock is not in the same position as a man who has lent a long-term loan to a private individual. Government stock is readily marketable and the man who owns Government stock can always convert it into cash; but the man who has lent a certain sum of money to a private individual will find that his capital is tied up for a long period. Long-term loans lent to a Government differ from long-term loans lent to private individuals in

the method of repayment. A man who lends a certain sum of money to a Government for a long period cannot be sure of getting back the same sum. The Government may try to reduce the National Debt and there are various ways of reducing the National Debt. The Government may have recourse to inflation. Inflation of the currency is one method of reducing the National Debt, and this method has been employed in varying degree by many Governments.¹ This is a fact known to all those who have studied Public Finance. Even repudiation is not altogether unknown.² Any principles that we may formulate with reference to long-term credit may not be applicable to long-term loans lent to a Government. I have, therefore, left out such loans. For somewhat similar reasons I have left out long-term debts borrowed by local bodies like municipalities.

I have similarly excluded long-term loans lent by one Government to another Government. Such loans are becoming more and more common. Recently the American Government decided to lend a long-term loan to Britain. Under the well-known Anglo-American Financial Agreement, which has

1. See below, Chap. IV, Sect. 4.

2. See Hugh Dalton, "Public Finance", (11th Ed.), pp. 265-266.

been recently ratified by Congress, America is to give a loan of 3750 million dollars to Britain. An agreement of this kind cannot be enforced in any court of law, because the parties are sovereign States. We cannot say what course a long-term loan lent by one Government to another Government will take. Apart from this, an inter-governmental loan is not a mere loan transaction. The object of the loan may be to promote trade between the countries or regions controlled by the two Governments. The Government lending the loan may obtain some political or economic privileges in return for the loan. In that case the whole of the money lent may not be returned; or the money may be lent at a specially low rate of interest. We cannot enunciate any general principles with reference to such loans. These loans have been therefore left out of consideration.

What about debentures issued by industrial and commercial firms, and by credit institutions providing long-term credit? They are in a sense long-term loans carrying a certain rate of interest. But the persons who buy such debentures are not in the same position as those who have lent money to private individuals for long periods. The capital invested in debentures is not necessarily tied

up for long periods. Debentures can be readily sold, if the firms which have issued them are financially sound. Thus one of the greatest difficulties connected with long-term loans does not exist in the case of these debentures. A man who has invested his money in debentures may not be a lender at all; he may be a speculator in stocks and shares. Further, the rate of interest on debentures may not have any relation to the rate of interest on long-term loans lent to private individuals, at least in this country.¹ The rate of interest on long-term loans lent to individuals is determined by a peculiar process.² Thus long-term loans lent to individuals have not much in common with debentures.³ If the term long-term credit is made to include debentures (which are in one sense long-term loans), we are in danger of arriving at conclusions which are not in accord with facts.

The term long-term credit, as it is used in this treatise, includes all long-term loans lent to private individuals. The loans may be lent by the Government, or by credit institutions

1. See below, Chap. III, Sect. 1.

2. See below, Chap. III, Sect. 2.

3. But they have much to do with debentures. The debentures issued by credit institutions providing long-term loans are a source of long-term credit (See below, Chap. VI, Sect. 1), though they may not be long-term loans in themselves. A credit institution which has to provide long-term credit on a large scale finds that the best way of raising the required long-term funds is to float debentures.

like land-mortgage banks, or by private individuals. The term also includes long-term loans advanced to commercial and industrial concerns. These are distinct from debentures. Such loans may be advanced by the Government, or by a credit institution like an industrial credit corporation.

I have attempted a definition of long-term credit in Chapter I. Whatever definition of long-term credit we may adopt, we have to bear in mind that short-term credit shades into long-term credit by imperceptible advances. If a long-term loan is defined as a loan for any period more than 10 years, a loan for 11 years is a long-term loan, whereas a loan for 10 years is not. There is no difference between a loan for 11 years and a loan for 10 years. But between the more marked examples of long-term credit and the more marked examples of other forms of credit, there is a world of difference. Long-term credit, as a subject, requires to be treated separately.

CHAPTER I

THE NATURE OF LONG-TERM CREDIT

1

We cannot go far in our study of long-term credit without some knowledge of its essential characteristics. Let us first try to define long-term credit. The man in the street has no clear notions regarding long-term credit. To him even a loan for a period of five years is a long-term loan. This is because he has no conception of medium-term credit. Even the Central Banking Enquiry Committee Report does not contain a satisfactory definition of long-term credit. The three classes of credit (short-term, intermediate and long-term) are not clearly defined in the Central Banking Enquiry Committee Report. It must be frankly confessed that it is not possible to give a precise definition of long-term credit. The dividing line between long-term credit and other forms of credit must be drawn more or less arbitrarily. But for working purposes we need only a rough definition of long-term credit. It is impossible to give off-hand even

a rough definition of long-term credit; but we shall get an idea of long-term credit which is sufficiently accurate if we examine certain relevant facts. It is not necessary to observe a large number of facts. My classification of the various forms of credit is based on a few relevant facts taken at random. It must be always remembered that the dividing line between long- and medium-term credit and that between medium- and short-term credit must in the last resort be drawn more or less arbitrarily.

Three classes of credit may be distinguished: (1) long-term credit, (2) medium-term credit and (3) short-term credit.

Short-term credit.- A person who borrows from a bank a short-term loan expects to repay it within a few months. He executes a promissory note, and usually undertakes to repay the loan after three months. Often the loan is renewed at the end of the period. In a few cases it is renewed again and again. But the maximum period for which an ordinary commercial bank grants a loan is rarely more than nine months or a year in the aggregate. The Reserve Bank of India undertakes to purchase or rediscount bills of exchange and promissory notes, drawn and payable in India and bearing two or more good signatures, one

of which shall be that of a scheduled bank, or a provincial co-operative bank, and drawn or issued for the purpose of financing seasonal agricultural operations or the marketing of crops, and maturing within nine months from the date of such purchase or rediscount.¹ The maximum period allowed by the Reserve Bank of India appears to be nine months. In the case of advances made by the Imperial Bank of India for the purpose of financing seasonal agricultural operations, the maximum period has been extended from 6 months to 9 months.² We may, therefore, regard nine months as the maximum period for which a short-term loan is made.

But the banking habit has not been fully developed in India. Of the many persons in rural areas who are in need of short-term loans, very few approach a commercial Bank or a co-operative credit society. They usually borrow from private persons, including professional money-lenders. Even in towns and cities many persons borrow from private individuals. When a man borrows from a private person on short term, he may undertake to repay it on demand. When a loan is borrowed on these terms, it is usually repaid in

1. The Reserve Bank of India Act, 1934, Section 17 (2) b.

2. The Imperial Bank of India (Amendment) Act, 1934, Section 15 (3).

3 years. The period of limitation for money lent under an agreement that it shall be payable on demand is three years from the date on which it is lent.¹ But we cannot regard three years as the maximum period for which a short-term loan can be made. The loans which are repayable on demand do not belong to any particular class, although the people who go in for such loans regard them as short-term loans. They are not short-term loans, since they are in many cases repaid at the end of the period of limitation. Nor are they medium-term loans, since they are repayable on demand. We may define a short-term loan as a loan made for any period less than a year.

When we come to agricultural finance we have to modify our conception of short-term credit. In rural areas even money which is borrowed in connection with seasonal agricultural operations is rarely repaid within a year. In such cases the borrower may take as many as three years to repay the loan. In many cases the borrower is not to be blamed. All his calculations may be upset by the failure of crops, and the failure of crops is not a rare thing in India. We must, therefore, make some allowance for the failure of

1. See Article 59 of the First Schedule to the Indian Limitation Act of 1908.

crops and for bad harvests when we make advances to agriculturists. It will be much better if agricultural finance is based on the agricultural cycle. In the case of agricultural finance, three years may be regarded as the maximum period of a short-term loan.¹

Medium-and long-term credit: It is convenient to distinguish between medium-term loans and long-term loans. Where is the boundary line to be drawn? Land-mortgage banks and other credit institutions which exist for the purpose of dispensing long-term loans usually make advances for 20 years or more. In certain parts of South India a man who wants a long-term loan sometimes joins a Kuri or Chit Fund. Now Kuries and Chit Funds usually run for more than 10 years, and are regarded as sources of long-term credit. The successful bidder at the first annual auction in effect gets a loan for a period which usually exceeds 10 years.² Prof. S. K. Muranjan, an authority on Indian Banking, is of the opinion that the period of loans advanced by land-mortgage banks should be from 10 to 20 years.³ We may, therefore, regard a loan for any period more than 10 years as a long-term loan.

1. See Report on Co-operation in India, 1915, p. 12.

2. Kuries and Chit Funds are described in Chap. V, Sect. 5.

3. Prof. S. K. Muranjan, "Modern Banking in India", (1940) p. 407.

A loan made for any period from one to ten years may be regarded as a medium-term loan.

I find that my classification on the whole agrees with that adopted by Mr. Benham in his book on Economics. Describing the different forms of credit, he says, "It is perhaps customary to call a loan made for any period less than a year a short-term loan, one made for any period from one to, say, ten years a medium-term loan, and others long-term loans."¹

What is the maximum period for which a long-term loan can be made? Most credit institutions which provide long-term credit lend money for 20 years or more. The Madras Government which lends money to agriculturists under the Agriculturists' Loans Act of 1884 grants loans for a period of 25 years.² But a period of 20 or 25 years is not considered long enough by many. One of the recommendations of the 11th Co-operative Registrars' Conference held in Delhi was that the maximum period of long-term loans should be extended to 40 years.³ I find that in some

1. Benham, "Economics" (2nd Ed.), p. 260.

2. See Rule III (2) of the rules for the grant of loans for the relief of indebtedness under the Agriculturists' Loans Act, 1884, as amended by the Madras Government Act XVI of 1935.

3. "Economic Problems of Modern India", ed. Radhakamal Mukerjee, Vol. 1. (1939), Chap. X, p. 195.

Western countries certain credit institutions make advances far still longer periods. The maximum period allowed for repaying long-term loans is 50 years in Italy and Japan, 54½ years in Austria, 57 years in Switzerland, 60 years in Denmark, 63 years in Hungary, 68½ years in Ireland and 75 years in France.¹

2

We will now examine the nature of long-term credit. Characteristics which are common to all forms of credit may be disregarded. We can best approach this subject (the nature of long-term credit) by noting the differences between long- and short-term credit. One fundamental difference between long- and short-term credit must be noted at the very outset. An agriculturist who borrows a short-term loan repays it at the end of a few months out of his gross income for the year. Suppose the same agriculturist borrows a long-term loan which must be repaid at the end of 20 years. He will not repay the loan at the end of 20 years out of his gross income for the last year. In this case the loan is repaid out of annual savings. Sometimes the loan is repaid

1. "Rural Credits" by Herrick. Quoted in the Central Banking Enquiry Committee Report, para. 100.

out of the profit which accrues to him. The profit may be due to a judicious use of the loan. Or it may be due to a saving in interest charges. (It is a matter of common knowledge that in this country the rate of interest on long-term loans is generally lower than the rate of interest on short-term loans.) In some cases the long-term loan may be paid in part from the profit which accrues to the borrower and in part from his annual savings.

But in each case the borrower sets aside a certain sum of money every year, and when he has saved enough he repays the loan. There are one or two apparent exceptions. Suppose a man expects to receive a legacy at the end of 12 years. He may borrow a long-term loan in anticipation of his legacy. In that case the man is literally living on the future. At the end of 12 years, when he receives the legacy, he pays off the loan. In this case he has not repaid the loan out of annual savings, although the loan is a long-term one. But such cases are very rare. Moreover, it is impossible for a man to borrow a long-term loan in anticipation of a legacy unless he is in a position to offer sufficient security. Or take the case of a speculator in real estate. Suppose a speculator in real estate buys an estate now, hoping to sell it at a profit

after 12 years. If he has not enough money with which to buy the estate, he may raise a long-term loan on the security of the estate he buys, or on the security of some other estate. At the end of 12 years he sells the estate and repays the loan out of the proceeds of the sale. In this case too the long-term loan is not repaid out of annual savings. But such cases very rarely occur. A speculator in real estate does not go in for a long-term loan. He cannot carry on his business without enough capital. He may borrow now and then, but he borrows short rather than long. One other exception may be noted. A landowner who is in debt may like to pay off his debts by selling a part of his estate. Suppose he hopes to secure a high price after 12 years. He may pay his present debts by raising a long-term loan on the security of his estate. At the end of 12 years he sells a part of his estate for a fair price and repays the long-term loan which he has borrowed. This particular long-term loan is not repaid out of savings, although according to our theory all long-term loans are repaid out of annual savings. But under these circumstances a landowner very rarely borrows a long-term loan. Although he expects to get a fair price for his land after

12 years, he is not absolutely sure. The value of land may suddenly go up; he may not have to wait for 12 years. The landowner will, therefore, borrow a medium-term loan on the security of his estate. If he cannot dispose of his land at the end of the period for which the loan is made, he will renew the loan, or he will go in for a new loan.

It will thus be seen that for all practical purposes a long-term loan is repayable out of annual savings. But the practical bearings of this important truth are seldom appreciated to the full. A man borrows a long-term loan on the security of his land. Every year he must pay interest on the loan, and must set aside a certain sum of money towards the repayment of the principal. But he only pays interest every year; he does not save, every year, the required sum of money. Result: when the loan becomes due, he is not in a position to repay it; he either renews it or borrows a new loan. In this case, the long term loan has proved a curse; the man has been lulled by a false sense of security. Sometimes a man borrows a long-term loan for a period which is not sufficiently long. Suppose a man whose net annual savings amount to Rs. 48/- borrows Rs. 1200/- for a period of 12 years. It is clear that he cannot repay the loan at the end of

12 years; he has to borrow a fresh loan on the security of his immovable property. This involves considerable trouble and expense.

3

A long-term loan is a peculiar thing. It is a much more complex affair than a short-term loan. In estimating the utility of a long-term loan, we have to take into consideration several factors. It is worth while to consider these. Some of the points mentioned below may appear small and technical, but a consideration of these points will lead to a better understanding of the nature of long-term credit. The success of a long-term loan depends on two things: first, the amount of the loan, and second, the manner of repayment. When a man who is in debt borrows a long-term loan, the amount borrowed must be sufficient to discharge all his liabilities. If the amount borrowed is not sufficiently large, some debts will remain. He has to pay high rates of interest on these debts, and these debts will grow. Before long the man will find himself in a mess.

In the case of loans made for a long period, the creditor must insist on two things. The borrower should make full disclosure of his

liabilities. The creditor must also insist that the money borrowed should be utilized exclusively for the purpose mentioned in the bond. If the money is used for some other purpose, the creditor should have the right to cancel the loan and to recover the money from the borrower immediately.

As regards repayment of a long-term loan, one of the most important things is the period of the loan. In fixing the period, due regard must be had to the repaying capacity of the borrower. The Central Banking Enquiry Committee thought that "the long-term loan..... advanced should be repayable from the margin of profit of the borrower's holding without putting him to the necessity of starving his current financial needs (domestic and occupational), or of borrowing from another source, or of selling his holding to discharge the loan". (The committee had in mind long-term loans lent to agriculturists)¹ We must take into consideration the annual net savings of the borrower. Every year he must be able to pay, without undue difficulty, the interest due as well as the stipulated portion of the principal. If during the currency of the loan he has to

1. Central Banking Enquiry Committee Report, para 100.

incur heavy expenditure in connection with the marriage of his daughter or daughters, or in some other connection, we must make provision for such expenditure. If he is able to save enough money every year, he can incur such expenditure without having recourse to borrowing. If he is forced to borrow a fresh loan he must, every year, pay interest on this loan as well as a part of the old loan. In addition, he has to make the usual payments in connection with the first loan. In every such case the payment of the first loan must be spread over a very large number of years. Otherwise a long-term loan may be worse than useless. This does not mean that every long-term loan is repaid by instalments. But even though a long-term loan is not repayable by instalments, the debtor must every year make proper provision for repayment by setting aside the requisite sum of money towards the repayment of the principal.

This brings us to the question of instalments. A long-term loan which is not repayable by instalments sometimes proves to be a dangerous thing. The borrower, if he is reckless or unbusinesslike, does not make any provision for repayment until the very end; he will be content to pay the yearly interest.

He tries to find ways and means of repaying the loan when it is too late. There is no such danger in the case of a loan which is to be repaid by instalments. This leads to a principle of great importance. The regular payment of instalments must be insisted upon. In case of default in payment of any instalment the creditor should have the right to sue for the whole amount due. This does not mean that the debtor should not default on any account. Suppose the debtor is forced to incur extra expenditure during a particular year. Let us suppose that the extra expenditure is justified and could not have been foreseen. It would be unreasonable to compel the debtor to pay the yearly instalment. If he is compelled to do so he will borrow the required amount. This will make it still more difficult for him to pay the next instalment. In certain unavoidable circumstances the debtor may, at his option, suspend payment. In the following year he pays only one instalment. The debtor should not be compelled to pay more than one instalment during any year. This means that whenever the debtor suspends payment the period of the loan is increased by one year. But a debtor can suspend payment only a certain number of times during the currency of a long-term loan payable by instalments.

The number must be clearly stated in the bond which he executes at the time of borrowing the loan.¹

One other point may be considered in this connection. Should a man who has borrowed a long-term loan repayable by instalments be allowed to pay the outstanding principal whenever it is convenient and desirable for him to do so? Suppose a man borrows Rs. 2000/- and undertakes to pay back the money in 20 yearly instalments. Suppose he comes into a fortune after he had paid 6 instalments. Should he have the right to pay the outstanding principal in a lump as soon as he is in a position to do so? I think he should have that right. A man who commits himself many years in advance must be allowed some latitude. The position of the creditor will be somewhat awkward if the debtor, after paying one or two instalments, pays in a lump the principal amount due. The

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1. When I was discussing within myself the need for such an arrangement, I had no idea that some credit institutions had foreseen the need for this sort of arrangement. I now find that the Bombay Provincial Co-operative Land Mortgage Bank is prepared to suspend the payment of instalment of principal when it is satisfied that such suspension is necessary. The rules which it has framed in this connection appear to be very reasonable. Suspension shall not be granted unless and until the interest accrued on the loan has been recovered in full. When any instalment is suspended all subsequent instalments may be deferred for the same period for which the instalment is suspended. Such suspensions shall not in the aggregate exceed by more than one-fifth the period of the loan— See By-Law 67 of the Bombay Provincial Co-operative Land-Mortgage Bank.

creditor will have no cause for complaint if the debtor is given the right to pay the outstanding principal in a lump after a certain stipulated period. The period must be clearly stated in the bond executed by the borrower.

While on this subject, I may say a few words as to the way in which the instalments are arranged. The instalments may be arranged in two ways. Let us consider these in turn. A long-term loan may be made repayable by equal annual instalments discharging both principal and interest. This, I believe, is called the system of equated payments. The system is simple. The debtor does not pay the interest separately. Every year he pays a certain sum of money and the loan is discharged when the last instalment is paid. Many, if not most, credit institutions providing long-term credit prefer this system. The Madras Government seems to prefer this system.¹ But this system has certain disadvantages. Under this system the debtor has to pay a fixed sum of money every year, and cannot suspend payment in any year during the currency of the loan. As we have seen, if the debtor suspends payment once, the

1. See Rule X (1) of the Rules for the grant of loans for the relief of indebtedness under the Agriculturists' Loans' Act, 1884, as amended by the Madras Act XVI of 1934.

period of the loan is increased by one year. This should not happen under the system of equated payments. If the period of the loan is altered, the whole arrangement will be upset. If the period is altered, the amount which the debtor has to pay every year has to be calculated on a different basis. Nor can the creditor allow the debtor to pay the outstanding principal in a lump after a stipulated period. We have seen that it is necessary to give this right to the debtor. Let us see what happens under the system of equated payments, if the debtor is to exercise this right. Suppose a man takes out a loan for Rs. 1000/- from a land-mortgage bank. Suppose the loan is to be repaid by equal annual instalments discharging both principal and interest. If the period of the loan is 20 years and if the rate of interest is $6\frac{1}{2}$ per cent, he has to pay yearly Rs. 90-12-1. The debtor, after paying 10 instalments, wants to pay the remaining portion of the loan in a lump. How much should he pay? Ten instalments are due from him. Should he pay 10 times Rs. 90-12-1? Of course not. The loan has not run its course and how much can be claimed from the debtor must be calculated on a different basis. This complication will arise under the system of equated payments.

Let us now consider the other way of arranging the instalments. The borrower may undertake to pay each year a stipulated portion of the loan and interest on the outstanding principal. Under this system the annual instalments will not be equal. It is clear that the complications I have just referred to will not arise under this system, provided the debtor pays every year interest on the outstanding principal. There is, however, one disadvantage about this system. The debtor has to pay substantially large sums during the first few years. This is because of the heavy interest charges. This will be felt by a debtor, especially if he has invested the money in some productive undertaking. During the first year his business may not yield any profit at all. But this difficulty can be overcome. The debtor may, with the consent of the creditor, postpone the payment of the first instalment to the end of the second or the third year, paying every year only the interest on the principal. Under an ideal system of long-term credit every debtor should be allowed to do this.

4

A man who wishes to borrow money for a long period must be prepared to mortgage a

part or the whole of his immovable property. It is difficult to obtain a long-term loan without such security. It is well known that long-term loans are generally mortgage loans. That long-term loans are mortgage loans is taken for granted. Are long-term loans necessarily mortgage loans? The subject is more important than most people imagine. Its practical bearings will be noted later. Let us first see whether long-term loans are necessarily mortgage loans. It is fairly obvious that a man who makes advances for long periods on personal security takes risks which no practical and sensible man will take. The risk of default increases with the period for which the loan is made. (I am speaking here of loans borrowed by private individuals). In the first place, the borrower may not live to repay the loan. In the second place, his credit may deteriorate in two ways: first, the market value of his assets may fall, second, his liabilities may increase, the value of his assets remaining the same. There is, of course, less risk if the borrower produces some sureties. But none will be willing to stand surety for a man who borrows a long-term loan. A man may stand surety for a borrower who undertakes to repay the loan after a few

months. But the same man will not hold himself responsible for the repayment of the loan if the loan is to be repaid after 20 years. Who knows what will be the position after 20 years? Can a man get a long-term loan on the security of his movable property? I believe no lender will be satisfied with such security. The movable property which is offered as security may deteriorate. But, it will be said, things like gold and silver are durable. If the loan is a short-term loan, gold and silver ornaments may be accepted as security. But if the period of the loan is very long there is considerable risk. The value of the ornaments may fall. There have been great fluctuations in the value of gold and silver. It is true that the value of immovable property like land is also subject to fluctuations, but usually there will be no great and sudden fluctuations in the value of land. The value of land may be said to be fairly constant over long periods. This is because the extent of any particular kind of land in a place cannot be easily increased or reduced. There is another reason why a man will not accept movable property as security for long-term loans. The thing or things may be lost, or stolen. This risk is not very great if the period of the loan is short. The longer the period, the greater the risk.

So far we have been discussing the problem from the point of view of the lender. What of the borrower? It does not occur to many people that a man who needs a long-term loan is not prepared to offer his movable property as security, even if the lender is willing to accept such security. If he pledges his movable property he cannot have the use of it during the currency of the loan. He cannot pledge his movable property and keep it. He may be prepared to forego the use of his property for a short period. But what borrower is prepared to forego the use of any of his movable property for a long period? He might as well sell it. A borrower who pledges his movable property does not get interest on the money invested in the property. A man will not obtain a long-term loan on the security of his movable property. If he has no immovable property which he can offer as security, he will raise the necessary sum of money by selling a part of his movable property rather than borrow a long-term loan on the security of such property. The difficulty referred to above does not exist in the case of immovable property. Any immovable property which is offered as security for a loan will be enjoyed by the borrower even during the currency of the loan. It is only in the event

of default that he loses his property. We find that people who go in for long-term loans always mortgage their immovable property to lenders. From this we can conclude that long-term loans are necessarily mortgage loans.

What kind of security is expected and offered in the case of long-term loans? The thing offered as security, whatever it is, must satisfy certain conditions. It is worthwhile to see what conditions must be satisfied. The thing which is offered as security must satisfy the following conditions: (1) It must be durable. (2) It must be such that it cannot be lost or stolen. (3) Its value must fairly be constant over long periods. (4) It must be capable of being used by the borrower even during the currency of the loan. Is there any thing other than immovable property which satisfies these conditions? This question is discussed at some length in Chapter IV, Section 1. Here it is sufficient to note that, as things stand, immovable property is the only thing which can be offered as security for a long-term loan. Its practical bearings must be noted. Since men and institutions making long-term advances expect the borrower to mortgage his immovable property, only persons who own immovable property of

some kind can borrow money on longterm. A man who badly needs a loan for long-term purposes must be satisfied with a short-term loan if he has no immovable property which he can offer as security. This raises a very important problem, a problem which is well-nigh insoluble. This problem is discussed in Chapter IV, Section 1. Further, the fact that only persons with immovable property can go in for long-term loans affects the rate of interest on such loans.¹

5

It is a matter of common knowledge that ordinary banks do not usually dispense long-term loans to their customers. By ordinary banks I mean ordinary commercial banks, private and public, and ordinary co-operative credit institutions, rural or urban. The term will be used in this sense throughout. The same bank will not usually provide both short-term and long-term credit. A moment's reflection will show that ordinary banks cannot make long-term advances without violating some fundamental principles of banking. They can, by reason of the character of their resources, supply only short-term credit. They make advances to their clients

1. See below, Chap. III, Sect. 2.

mostly out of the depositors' money. A deposit with a bank may be on current account or on deposit account. Money left with the bank on current account can be withdrawn at any time, and it would be folly to make long-term advances with such money. Even the so-called fixed deposits can be withdrawn whenever needed. Usually a week's notice is required. But in practice a bank will permit a customer to withdraw without giving notice. An ordinary commercial bank cannot, therefore, grant long-term loans to its customers. There is another reason why it cannot do so. A bank can make long-term advances only with the money left with it on deposit account, if at all it can make long-term advances. Now a bank usually allows no interest on current accounts; but it pays interest on fixed deposits. It may so happen that the rate of interest charged by the bank on long-term loans is not much higher than the rate of interest on its deposits. This is because under present conditions the rate of interest on long-term loans, which are mortgage loans, is much lower than the rate of interest on short-term loans. There is thus not much difference between the lending and borrowing rates, so far as long-term loans are concerned. In normal times an ordinary bank will not find it worthwhile to

lend money for long periods on the security of immovable property. All of which goes to show that the same bank cannot dispense both short- and long-term credit.

In practice it may be possible to segregate the two kinds of credit, both in regard to raising the capital and lending it. I learn that Diwan Bahadur K. Devashikamani Mudaliar, Joint Registrar of Co-operative Societies in the Madras Presidency, once formulated an excellent scheme for such segregation.¹ If the two kinds of credit are segregated in this way, we can dispense both short-term and long-term loans through the same bank. But in this case, we will have two different organizations providing two different kinds of credit, although the two organizations are run by the same person, or body of persons. This in no way invalidates our theory.

Some commercial banks perhaps can afford to make long-term advances. These are banks which derive their working capital mainly from share-capital. They do not rely on deposits to the same extent as other ordinary banks. But usually they do not find it worthwhile to lend on long term, the rate of

1. See the memorandum submitted by the Late Mr. V. Ramadas Pantulu on the proposed Provincial Co-operative House Building Society for the Madras Presidency, p. 3.

interest on long-term loans being usually lower than the rate of interest on short-term loans.¹ But the position may be different during an economic depression; then there may not be a great demand for short-term credit. Then indeed it may be worthwhile for those banks to lend on long term if there happens to be a demand for long-term credit. I know of one or two ordinary commercial banks which derive their working capital mainly from share-capital. The shares are owned by members of particular communities. These banks lent long-term loans on the security of immovable property during the last economic depression. But the organization of these banks is not typical; they are in the same position as private individuals who make advances out of their own money. These individuals can make both long- and short-term advances.

We conclude, therefore, that an ordinary bank cannot afford to make long-term advances to its customers. But the last word on this subject has not been said. In this country many people, including some bankers, believe that under certain circumstances an ordinary bank can make long-term advances to its customers. They seem to think that it is only lack of enterprise which prevents a bank from

1. See Chap. III, Sect. 2.

doing so. But then orthodox principles of banking administration are not always followed by banks in this country. After 1917 a number of banks were founded with professedly "industrial" functions, but all carry on commercial as well as industrial banking. "The union of industrial with commercial banking in the ordinary Joint-Stock Banks is specially dangerous in India as the paid-up capital of such banks is usually small, while deposits are mostly made for short periods only."¹ Something similar happened in Germany after the last Great War. German banks, as is well known, are "mixed institutions". In addition to ordinary banking business they undertake other kinds of business, such as providing industrial concerns with fixed capital. After the last Great War a large part of their current account advances were diverted to fixed investment. Now much of this money had been lent to the banks by foreign investors. When, as a result of the financial panic which started in 1931, the short-term funds supplied by foreign investors were withdrawn, the banks found themselves in difficulty.² If past experience

1. Dr. Vera Anstey, "The Economic Development of India", (1929), p. 408.

2. See the article "Continental Banking and Industry" by Mr. M. M. Mulky in the *Journal of the University of Bombay*, Vol. IX (new series), Part IV, pp. 67, 68.

is any guide, the kind of business referred to above (i. e. making long-term advances and providing industries with fixed capital) is not consistent with deposit banking practice.

6

There is one question of practical importance which I want to discuss before leaving this subject. As every man familiar with modern banking practice knows, commercial banks can actually create credit. They can rear a large superstructure of credit upon the stock of gold in their possession. This is made possible by the use of cheques. These commercial banks deal in cheques, and there is a continuous process of matching and cancelling credits and corresponding debits. Can banking institutions like land-mortgage banks which dispense long-term credit create credit in the sense in which the commercial banks create it? It may be that just now the question is not of very great practical importance. Even our commercial banks do not create credit to any appreciable extent. The cheque habit has not been fully developed in our country. But the tendency to use cheques is increasing.¹ At the present time there are many clearing houses in the country. The Reserve Bank, the

1. Jather and Beri, "Indian Economics" Vol. II, (1945), p. 384.

Imperial Bank, the Exchange Banks and leading Indian banks are members of these clearing houses. The Reserve Bank of India is the bankers' bank. The increased use of cheques will enable our commercial banks to create credit. Suppose the institutions which provide long-term credit are also in a position to create credit. They can make splendid use of their power to create credit. The demand for long-term credit is very great and it will increase; but the demand for long-term loans can be easily met if institutions like land-mortgage banks have the power to create credit.

But it is fairly obvious that banking institutions which dispense long-term loans cannot create credit in the sense in which commercial banks create it. Banking institutions which exist for the purpose of providing long-term credit do not deal in cheques. They receive only fixed deposits. Now money which is left with a bank on deposit account is not subject to withdrawal by cheque. When a land-mortgage bank makes a loan, it lends actual cash. It will not create a deposit in favour of the borrower and give him the right to draw cheques upon it, i. e. the bank.

If institutions which dispense long-term credit cannot create credit in this sense, they

can create credit in a different sense. Let us see what happens when there are no institutions for providing long-term credit. People in need of long-term loans have to approach individuals who are prepared to lend money for long periods. But a man who owns a very small sum of money cannot lend it for a long period, even if he is prepared to do so. If it is to be lent for a long period it must be lent on the security of immovable property, and the mortgage deed must be registered. This means much trouble and expense. It is very rarely that small sums of money are lent for long periods in this way. People who own small sums of money usually lend their money for short periods, although they are willing to lend their money for long periods on proper security. Now suppose there is a land-mortgage bank in the place. All these people who own small sums of money may be induced to deposit their money in the bank. Or they may be induced to invest their money in the debentures issued by the land-mortgage bank. In either case the money can be lent for long periods by the bank. The land-mortgage bank is able to make long-term advances with money which, but for the bank, would have been lent for short periods or invested in some other way. Banking institutions which exist

for the purpose of providing long-term credit can create long-term credit in the sense indicated above. By creating credit in this sense they can increase the volume of long-term credit in the country.¹

CHAPTER II

THE USES OF LONG-TERM CREDIT

1

Long-term credit has more than one use. People are vaguely aware of this or that use of long-term credit, but most people do not have any clear idea of the various uses of long-term credit. But in order to understand the place of long-term credit in modern economic life we must have some idea of the various purposes which a long-term loan can serve. The uses of long-term credit are so varied that they may appear at first sight to defy any attempt to reduce them to systematic statement. But the uses of long-term credit may be grouped under seven broad heads.

A long-term loan may be borrowed for productive purposes. Production is often indirect and involves the use of capital in the form of tools, machinery, and so on. If a man who is engaged in production of this sort does

1. This subject is further discussed in Chap. VI, Sect. 1.

not possess enough money with which to buy the necessary capital, he will go in for a loan, if he can secure one. With the money he has borrowed he will purchase the necessary capital. By using this capital properly he earns more than he would have earned otherwise. The loan is repaid out of the profits obtained by him. In most cases of this kind the loan is necessarily a long-term one. The man cannot repay the loan with the profits which he gets in a single year; but he can repay it out of the profits accruing to him over a series of years. This is perhaps the most legitimate use of long-term credit.

This use of long-term credit is best exemplified in industry. Production has become more indirect and drawn-out. Capital is being increasingly used. Most people engaged in production do not command sufficient capital. But they can provide themselves with the necessary capital by borrowing. If they are prudent and enterprising and can offer proper security, they will not have much difficulty in securing long-term loans, the only kind of loans which will be useful to them.

One would expect the demand for long-term credit to be very great in industry. But one actually finds that there is no great demand for long-term credit in industry at the

present time. This is partly explained by the modern organisation of industry. At the present time large-scale production is not possible without the agency of the joint-stock company. Large industrial concerns are generally conducted by joint-stock companies. The corporate combination of numerous individuals can supply the means of any undertaking. Most of the industrial concerns in the West raise capital by selling shares and debentures. There are so many agencies for promoting investment. In England and America there are investment trusts which provide industrial concerns with fixed capital. Joint-stock companies are often floated with the help of underwriters. In India many of these facilities do not exist. But still most industrial concerns derive a large part of their capital from shares and debentures, especially from shares. Industrial concerns in this country do not usually rely on banks or private money-lenders to supply them with long-term funds¹ The funds needed need not be borrowed. Of course, new machinery may have to be bought now and then. But every solvent business organisation will make provision for depreciation. Every year a part of the gross income is put back into the

1. See below, Chap. V, Sect. 4.

business. If there is a temporary deficit, the company will have recourse to borrowing. But what is needed in such cases is a short-term loan. If there is need for fresh investment, the company can issue more shares.

But what about one-man businesses and partnerships? They may conceivably be in need of long-term credit, especially in the initial stages. But a business man has not the slightest chance of securing a long-term loan if he has no immovable property which he can offer as security. Many producers who badly need long-term loans may not be able to offer such security. This limits the demand for long-term credit in industry. Although long-term credit has the greatest use in industry, there is no great demand for it in industry.

If there is any class of people which has greater need of long-term credit than any other class, it is the agricultural class. I am here speaking of long-term loans for productive purposes. Just now agriculturists who borrow long-term loans usually borrow them for unproductive purposes. But there can and should be a great demand for long-term credit for purposes of investment. Agriculture is a branch of production, and here also there is great scope for round-about production, which

involves the use of capital. The capital may be used in the form of implements, and machinery. Capital is needed for constructing wells, for erecting fences, and many other things. In a thickly populated country like India there is great need for intensive farming. More capital ought to be invested in the intensive cultivation of the land. Most agriculturists do not have sufficient funds. They should have recourse to borrowing. But short-term loans will not serve the purpose. The loans should be long-term loans. As agriculturists borrow these loans for productive purposes, there should not be any difficulty about repayment. Many of the agriculturists own some land and the problem of security does not arise in this case.

2

In the cases cited above long-term credit is used for the purpose of increasing production. In the cases cited above the use of long-term credit ultimately leads to increased production. Long-term credit may be used for a slightly different purpose. In this case also the money obtained through a long-term loan is invested, but not so as to increase production. The man who borrows the money invests it in such

a way that he can keep for himself that part of his annual income which would otherwise go to another. Let me mention a typical case. A man who lives in a rented house in a city has to pay a certain sum of money to his landlord every year by way of rent. What the landlord gets as rent, as everybody knows, includes interest on the money which he has invested as well as some other elements. As everybody knows, the income which he derives from his ownership of the house contains an element of profit. Thus the occupant of the house, who now pays a rent to the owner, will stand to gain by investing some money in a house of his own. He can either buy a house similar to the one he is now occupying, or build a similar house. If he has no money of his own, he can go in for a long-term loan. It will pay him to buy or construct a house for himself with borrowed money. It may fairly be assumed that the annual interest on the loan is less than the annual rent of the house. For the rent contains, besides interest, an element of profit. Everything, of course, depends on the current rate of interest on long-term loans and the ease with which such loans can be secured. If the man who is now living in a rented house can secure a long-term loan on the security of the house he proposes

to buy or build and if the rate of interest is reasonable, he should certainly go in for it. The money can be profitably invested, although it is borrowed money. Every year he can pay, without extra sacrifice, the interest on the loan as well as a part of the principal. The principal is paid out of the money which he is to save as a result of the investment. It is clear that the repayment of the principal has to be spread over a series of years. The house becomes his at the end of the period.

This kind of investment is possible in the case of other durable goods. A man generally finds it more profitable to own a durable good than to hire it, although in order to acquire it he may have to borrow. In the case of durable goods other than buildings, the question of proper security will arise. A man will find it difficult to obtain a long-term loan on the security of a machine which he proposes to buy. But a man can, without much difficulty, obtain a long-term loan on the security of a building he proposes to buy or construct.

3

So far we have been dealing with cases in which the money obtained through long-term loans is invested in some way or other. But

long-term credit has other uses.

A long-term loan will be extremely useful to a man who has to incur large expenses in connection with something which he cannot afford just now. Consider the case of a man with a small income who has to celebrate the marriage of some dependant. Just now he may not be able to spare the required sum of money. But by saving something every year he may be able to collect enough money at the end of 12 years or 15 years. But the marriage cannot be postponed. The difficulty can be solved by borrowing a long-term loan. The loan can be easily repaid after some years, provided he is able to save a certain sum of money every year. Thus a long-term loan will enable a man to utilize, *in advance*, his savings over a series of years. This case is different from the one mentioned in the previous section. In the case mentioned therein there is saving, but the saving is due to the fact that the money which is borrowed is invested in a certain way. The money is invested in a house and this results in considerable savings. Ultimately the loan is repaid out of savings. But in the case I have described in this section there is no investment. The long-term loan has only enabled the man to utilize *in advance* the money which he

would be able to save in 12 or 15 years.

4

A long-term loan may be borrowed for a slightly different purpose. Suppose a man expects a steady increase in his income. He can, in that case, maintain a standard of life which is higher than the standard of life which his present income would warrant. If he is quite sure of a steady increase in his earnings, he can borrow a long-term loan and during the first few months or years supplement his income with a part of the money he has borrowed. In this way he can, during this period, enjoy an income higher than his actual income. He can think of repayment when there is an appreciable increase in his income. Thereafter he will save something every year, and every year repay a part of the loan. If he does not borrow a long-term loan and utilize the money in the way indicated above, he will not spend the same amount of money every year; he will spend more and more as his income increases. But a long-term loan will enable him to spend at a more even rate by bringing forward some future income into the present.¹

1. This idea did not originally occur to me. It is found in some standard books on Economics.

A long-term loan serves a similar purpose in some cases of a slightly different kind. Suppose a man with a small income expects to receive a legacy after 12 years. He can bring forward some future income by means of a long-term loan. The loan will help him to maintain a higher standard of life during the intervening years. The loan can be repaid after he receives the legacy, either by instalments or in a lump.

5

There may be need for long-term credit in that kind of business which people call speculation. A speculator in real estate buys a piece of agricultural land in the hope that at some future date he will be able to sell it at a higher price. The chances are that the price will rise. But he must be prepared to wait for a long period. The price may not rise immediately, it may even fall. But at some time in the future it may be higher than what it is now. If the speculator waits till then and sells the land at this price, he may make a profit, even after making allowance for the interest on the money he has invested. If the speculator in real estate has no money of his own, he will buy the estate with

borrowed money. But the money must be borrowed for a long period. At some future date he will sell the land at a profit and repay the loan. This illustrates one use of long-term credit. But in practice few speculators in real estate go in for long-term loans.¹

6

A long-term loan is sometimes used for a peculiar purpose in this country. A man borrows a long-term loan in order to provide for the proper investment of his savings before the savings accumulate. This may appear absurd at first sight, but this is being actually done. It is quite common for an agriculturist to buy a piece of land in his own village or in some other village with borrowed money. The money is borrowed for a long period on the security of the land to be purchased, or of some other piece of land. The man who buys the land hopes to save enough money before the loan falls due. In this case the man does not expect to make a profit by selling it at a higher price. Nor does he invest the money in the land with a view to making a profit. Probably he can secure a better return to his money by simply lending it out at interest.

1. See above, Chap. I, Sect. 2.

In this case he buys the land solely to provide for the proper investment of the money he hopes to save in the course of the next few years. He can, of course, wait till he has accumulated enough money; but this particular piece of land which he wants may not remain unsold till then. So he has recourse to a long-term loan. This is among the least legitimate uses of long-term credit. The estate bought with borrowed money may prove to be a liability and the borrower may not be able to redeem it. The trouble is that many people in this country want to invest their money in land, whatever the return to their capital, and if they have not enough cash they will borrow a long-term loan and buy a piece of land, hoping to save enough by the time the loan becomes due. This is a common practice in India, and is the cause of much trouble. The Bombay Banking Enquiry Committee found that the purchase of land at heavy prices was one of the causes of indebtedness in that province.¹

7

Sometimes a long-term loan is not borrowed for any of the purposes mentioned above. It is borrowed under peculiar

1. The Bombay Banking Enquiry Committee Report, para 59.

circumstances. Many people in India who borrow money do not borrow according to any plan. A man who really needs a long-term loan is often content to borrow a short-term loan. It is clear that he cannot repay the loan within a short period. The loan must be renewed again and again. Such has been the experience of co-operative societies in India. The system of "fictitious repayments" existed even in the early days of the co-operative movement in India, and was condemned by the Committee on Co-operation in India, 1915.¹ As Prof. Muranjan says,² the loans are renewed as a matter of course. If the loan cannot be renewed, he borrows from another person to meet his loan when it falls due. He goes on borrowing and very often his debts increase in the process. He gets rid of old debts only to bring on new ones. In course of time his credit suffers. He cannot borrow on personal security. The only course open to him is to mortgage his immovable property (if he has any) to some credit institution or money-lender and secure a long-term loan. Thus a series of short-term loans often ends in a long-term loan. Such is the origin of most long-term loans. The Madras Banking

1. See the Report on Co-operation in India, 1915, para 12.

2. Prof. S. K. Muranjan, "Modern Banking in India", (1940), pp. 55-56.

Enquiry Committee referred to this peculiar state of affairs in its Report. The short-term loan accumulates until a mortgage is unavoidable.¹ Such was the case in the Bombay Presidency also.²

Many people in this country borrow recklessly. Most short-term loans are borrowed for unproductive purposes. The U. P. Banking Enquiry Committee estimated that 70% of the debt existing at the time was borrowed for unproductive purposes.³ The conditions in other parts of India were hardly better. The Bombay Banking Enquiry Committee found that a large portion of the debt was taken for unproductive purposes.⁴ Since most of the short-term loans are borrowed for unproductive purposes and since many of them carry a high rate of interest, the loans are not usually repaid, when they fall due. A long-term loan will generally help a borrower to repay the short-term loans. Since the rate of interest is generally lower and since the period of the loan is sufficiently long, he can repay the loan without much difficulty. It is only a long-term loan on easy terms that can save a

1. The Madras Banking Enquiry Committee Report, Para 100.

2. The Bombay Banking Enquiry Committee Report, Para 64.

3. The U. P. Banking Enquiry Committee Report, para 84.

4. The Bombay Banking Enquiry Committee Report, para 63.

borrower who is unable to repay the short-term loans he has borrowed, if at all he can be saved. Thus a long-term loan is often necessary for repaying short-term loans. In view of the peculiar conditions which prevail in our country, this may be included among the uses of long-term credit.

8

Many people in India who borrow money do not borrow according to any plan. They do not discriminate between short- and long-term loans. A man who is badly in need of a long-term loan is often content to borrow a short-term loan. It is clear that he cannot repay the loan within a short period. Sooner or later he has to borrow a long-term loan. If he cannot secure one in time, either he or his creditor will suffer. Of course, it is generally the borrower who suffers. There is a crisis in his financial affairs, and the crisis is sometimes followed by bankruptcy. If there is no bankruptcy there is usually great loss. All this would not have occurred if the borrower had at the very beginning obtained a long-term loan on reasonable terms. The fact is that most people in this country are not fully aware of the various uses of long-term

credit. The dispensing of short-term loans for long-term purposes and vice-versa is very common.¹ There is no doubt that this is one of the causes of the chronic indebtedness which exists among agriculturists in India.

Finally, it may be noted that long-term credit has a much larger number of uses than other forms of credit. Many and varied are the uses of long-term credit. As we saw in the previous chapter, a long-term loan may be a snare and a curse, but a judicious use of long-term credit is sure to increase economic welfare. Sometimes, as when it is used in production, it can increase a man's monetary resources. In other cases it will enable a man to make the most of his monetary resources. Certain monetary resources will be available to a man during certain periods in his life. By a judicious use of long-term credit he can make the most of these resources.

CHAPTER III

INTEREST ON LONG-TERM LOANS

1

It is necessary to investigate the forces which govern the rate of interest on long-term

1. "Economic Problems of Modern India", ed. Radhakamal Mukerjee, Vol. I, (1939), p. 185.

loans. These forces are not the same as those which govern the rate of interest on short-term loans. Nor is there any direct connection between the two rates of interest. Moreover, there are some important problems concerning interest on long-term loans. These problems have to be carefully examined. It is, therefore, worth while to devote a separate chapter to this subject, i. e. interest on long-term loans.

It must be noted at the outset that in India it is extremely difficult to find the average rate of interest on long-term loans. There are not many well-organised credit institutions supplying long-term credit. In many parts of India people who are in need of long-term credit must rely solely on private individuals who are prepared to lend money for long periods. The latter do not charge a uniform rate of interest. The rates of interest on long-term loans are not obviously the same as long-term rates. When we speak of long-term rates we have in mind the yield on debentures of large and well-established industrial concerns, the yield on Government securities, etc. But here I am not dealing with long-term investments of this kind; I am dealing with long-term credit.

It may here be noted that in our country there is no connection between the rate of interest on long-term loans and long-term rates. The people who are prepared to lend their money for long periods, on the security of lands or other immovable property are not generally prepared to invest their money in debentures issued by joint-stock companies. But in England and other Western countries the rates of interest on long-term loans provided by private individuals are related to the long-term rates; they cannot vary greatly from the long-term rates. If a man who wants to lend money for a long period is not satisfied with the rate of interest offered by the borrower, he may invest it in some gilt-edged securities. But here in India the people who lend money for long periods to private individuals will not invest their money in any other way, whatever the rate of interest they receive from the borrowers

2

It is a matter of common knowledge that rates of interest on long-term loans are generally lower than the rates of interest on short-term loans. How are we to account for this difference? The layman would explain

the difference thus. Long-term loans are generally mortgage loans. The rate of interest charged in any particular case depends partly on the nature of the security offered. Long-term loans are borrowed on the security of immovable property. Therefore, the rates of interest on long-term loans must be necessarily low. But this is not the correct explanation. As things stand, long-term loans are *necessarily* mortgage loans. The question of proper security is most important in the case of such loans.¹ That a person who borrows a long-term loan offers good security for the loan is to be always taken for granted. The fact that he borrows it on the security of immovable property will not directly influence the rate of interest. Moreover, a man who borrows a loan on the security of his immovable property may not on that account be charged a lower rate of interest; on the contrary he may be charged a higher rate. I know of some reputable commercial banks which lend money for short periods on the security of goods, jewels, etc. If, however, they are not satisfied with the security which is offered, they will accept immovable property as collateral security. But the rate of interest is not

1. See above, Chap. 1, Sect. 4.

reduced when some immovable property is offered as collateral security; in some cases it is increased. The fact that long-term loans are usually borrowed on the security of land or buildings does not explain the lower rates of interest charged by institutions and persons who lend on long term. In fact we would expect the rate of interest on long-term loans to be higher than the rate of interest on short-term loans. A man who wants a long-term loan may be satisfied with a short-term loan for the time being. The loan can be renewed again and again; but this means so much trouble. A long-term loan will enable him to avoid this trouble. So he may be expected to offer a higher rate of interest in the case of a long-term loan. The explanation must be sought elsewhere.

The rate of interest on long-term loans depends on the demand for and the supply of long-term credit. At present the conditions of demand and supply are such that the rates of interest on long-term loans are lower than the rates of interest on short-term loans. But the conditions may alter. The rates of interest on long loans may conceivably be higher than the rates of interest on short loans.

Let us first consider the factors which affect the supply of long-term credit. It must not be supposed that all the people who wish to lend out their money at interest are equally willing to lend on long term. Many of them may not be prepared to lend their money for long periods. If, however, the borrowers offer sufficient inducements they may be willing to lend their money for considerably long periods on proper security. Such persons will naturally charge higher rates of interest on long-term loans. In India at least the majority of those who lend at long term do not belong to this class of lenders, for here long-term rates of interest are generally lower than short-term rates of interest. Evidently those who lend at long term deliberately prefer to lend their money for long periods. Among the people who lend out their money at interest there are many who prefer, for some reason or other, to lend on long term. Why should some people prefer to lend their money for long periods? They may want to provide for old age, or for the marriage of their daughters when they grow up, or they may like to make provision for their families. Some of them may have no particular use for the money which they have saved; in that case

the pride of accumulation may be the main cause of saving. All such people naturally prefer to lend their money for long periods on good security. If they are to lend their money for short periods, they have to find fresh borrowers now and then. This entails so much trouble; the money may be lying idle during certain periods; worse still, they may be tempted to spend a part of their money. All these things can be avoided if the money is lent for pretty long periods. Moreover, if they lend their money for long periods, they must necessarily lend it on good security.¹ Many of them are so eager to lend their money for long periods on good security that they are prepared to accept any rate of interest. The "Austrian" theory of interest does not apply to this class of lenders at least. On the contrary, the lower rates of interest charged by these lenders disprove the theory. According to Bohm-Bawerk, with whom the theory is usually associated, the fundamental reason for interest lies in the fact that a man prefers present to future satisfactions.² The

1. See above, Chap. 1, Sect. 4.

2. The essence of the theory is stated in Von Bohm-Bawerk's book, "Capital and Interest". ".....present goods invariably possess a greater value than future goods of the same number and kind, and

man who lends a certain sum of money must, therefore, be offered a rate of interest which is sufficient to balance the difference between the intensity of present and future satisfactions. A man may prefer an offer of Rs. 100/- now to an offer of Rs. 105/- at the end of one year. But an offer of Rs. 110/- at the end of one year may prove equally attractive. If he is to lend Rs. 100/- for one year, he will charge 10 per cent interest. Such is the "Austrian" theory of interest. Suppose he is to lend the money for three years. What rate of interest will he charge? Obviously he will not be satisfied with 10 per cent interest. Rs. 100/- now may be worth as much as Rs. 150/- at the end of three years; it may be worth as much as Rs. 200/- at the end of five years. If he is to lend Rs. 100/- for five years, he will certainly charge interest at a higher rate. The rate of interest should depend on the period of the loan; the longer the period, the higher the rate of interest.

But many lenders who lend on long term are satisfied with a rate of interest which is

therefore a definite sum of present goods can, as a rule, only be purchased by a larger sum of future goods. Present goods possess an agio in future goods. This agio is interest" Bohm Bawerk, "Capital and Interest" (William Smart's English translation), p. 259.

actually lower than the rates charged by those who lend money for short periods. Whatever truth there is in the "Austrian" theory of interest, the theory does not hold good in those cases in which long-term rates of interest are lower than short-term rates.¹ The same is true of the theory of interest as propounded by the late Lord Keynes. According to this famous economist the rate of interest is the reward for parting with liquidity for a specified period. Liquidity preference is one of the factors which determines the rate of interest, the other factor being the quantity of money available for investment. This is the essence of the well-known theory of interest propounded by Lord Keynes.² But this theory is not valid in at least those cases where the lender charges a lower rate of interest when the loan is borrowed for a longer period. For, according to the theory, the rate of interest demanded by the lender should depend on the length of the period during which his resources are locked up. The longer the period the higher the rate of interest demanded by the

1. So far as I know, this point has been ignored by the critics of the theory. I do not suggest that the point made by me invalidates the "Austrian" theory of interest. What I mean is the theory does not apply to a certain class of lenders.

2. Keynes, "The General Theory of Employment, Interest and Money", (1936 Ed.), pp. 167 168.

lender. A man who lends a certain sum of money for one year parts with liquidity for one year. So he expects a certain reward by way of interest. Suppose he is asked to lend the money for three years. He may not afford to part with liquidity for such a long period. But if he is offered a higher rate of interest he may think of lending the money for three years. Yet there are people who prefer to lend for long periods. These will lend their money at comparatively low rates of interest when the money is borrowed for fairly long periods. Evidently these people belong to a distinct class of lenders. It is they who supply long-term credit. If the demand for long-term credit increases, the demand can be met only if more persons are prepared to make advances for long periods. If the demand for long-term credit increases, some persons who are not ordinarily willing to lend their money for long periods may have to lend it for long periods. But then they will charge higher rates of interest; the rates of interest which they charge will be higher than the rates at which they lend their money for short periods. When this happens, long-term rates of interest will be higher than short-term rates.

Let us now consider the factors which influence the rates of interest on long-term

loans on the side of demand. The demand for long-term loans in a country like India is bound to be great. All sorts of persons need long-term credit. Long-term credit has a great variety of uses (See above, Chapter II). But what matters is the *effective* demand for long-term loans. Many people who are in need of credit would like to borrow long-term loans; only long-term loans on easy terms would solve their problem. But they are debarred from borrowing long-term loans, for they have no sufficient immovable property which they can offer as security. Long-term loans have to be borrowed on the security of immovable property. Thus only a restricted number of borrowers can go in for long-term loans. This fact limits the demand for long-term credit, and thus affects the rates of interest on long-term loans. Just now the rates of interest on long-term loans tend to be lower than short-term rates partly because of this fact. But the fact that long-term loans have to be borrowed on the security of immovable property does not directly affect long-term rates, as many people imagine; it affects them indirectly, by limiting the demand for long-term loans.

From what has been said above it is clear that long-term rates of interest need not be

necessarily lower than short-term rates. Long-term rates of interest are not directly related to short-term rates. They depend on the demand for and supply of long-term credit. A time may come when even in India the rates of interest on long-term loans may be higher than the rates of interest charged on short-term loans. Certain factors will tend to raise the long-term rates of interest. Just now most people who want to invest their savings at long term think of only one way of investing their savings; they invariably lend their money for pretty long periods on the security of immovable property. They are not interested in other kinds of long-term investments. This, however, is much better than hoarding, which was until recently so common in India; it represents the first stage in the investment of capital. The next stage may arrive soon; then people who want to invest their money at long term will be interested in other kinds of long-term investment. They may buy long-term securities instead of lending their money for long periods on the security of immovable property. There are many classes of long-term securities in the case of which the risk of default is practically negligible. The scope for long-term investments of this kind is somewhat

limited at present, but there will be greater scope for such investments in future. The possibilities of industrial development are enormous in India, and India is sure to make some progress in the industrial field. This may affect the supply of long-term credit; the rates of interest on long-term loans may rise. But individual and corporate savings increase with prosperity. This will tend to lower the rates of interest on all classes of loans. So long-term rates may not be higher than what they are now; but short-term rates will fall; ultimately long-term rates of interest may be somewhat higher than the short-term rates.

3

As already stated, long-term rates of interest are not directly related to short-term rates. A rise in long-term rates of interest may not be accompanied by any rise in short-term rates; or they may move in opposite directions. They sometimes tend to move in opposite directions. Twice in the course of the last fifteen years they have moved in opposite directions. During the last economic depression which began in 1929 short-term rates of interest fell considerably. The average rate of interest on short-term loans

was markedly low, and it continued to be low for a long time.¹ But immediately after the depression set in, the long-term rates of interest began to rise. The reasons for this rise in the rates of interest on long-term loans may be summarized as follows:—

As every student of Economics knows, a depression usually comes after a boom. For some years after the last war, there was a boom in Indian agriculture. The prices of agricultural commodities rose. The rise of prices created too great an enthusiasm. Land values rose in many parts of India. As Mr. Darling says, a rise of prices is generally followed by an increase of indebtedness.² Most Indian agriculturists borrowed recklessly during this period. The economic depression brought about a sudden change in the position of the Indian agriculturists. There was a catastrophic fall in agricultural prices, and land values began to fall. The value of the security which landowners could offer for long-term loans was greatly reduced; people who were ready to invest their money on long term were not very keen on lending it on the security of land. This by itself would have

1. Prof. S. K. Muranjan, "Modern Banking in India," (1940), p. 52.

2. Mr. Darling, "The Punjab Peasant in Prosperity and Debt", pp. 16 and 40.

raised long-term rates of interest to a certain extent. But there was another factor which had the same effect. The demand for long-term credit increased greatly. When agricultural prices fell, the money incomes of the agricultural classes fell too. But there was no corresponding decrease in their expenditure. The rates of interest on the loans which they had borrowed remained almost the same. As we saw just now, they had been borrowing freely for some years before the depression. The burden of land revenue was not immediately reduced; even when the rates of assessment were reduced the landowners did not get much relief, because the remissions were niggardly. Many of the landowners had to educate their sons, and the cost of secondary and college education was as high as ever. The *real* income of all the landowners who were in debt fell heavily. They were reduced to a serious plight. Many of them could not repay the loans they had borrowed. Indeed, during the depression repayments were very rare, and even interest payments fell into arrears.¹ All this led to an increase in mortgage indebtedness. Only long-term loans could save

1. "Economic Problems of Modern India", Ed. Radhakamal Mukerjee, Vol. 1, (1939), Chap. IX, p 176. Chap. IX has been contributed by Dr P. J. Thomas and deals with rural indebtedness.

these agricultural debtors. So the demand for long-term loans increased. When the demand for long-term loans increased, the long-term rates of interest rose.

This is how an economic depression affects Indian agriculturists. Whenever there is an economic depression, the rates of interest on long-term loans may be expected to rise.¹

But short-term rates of interest tend to fall during an economic depression. This is mainly because an economic depression is accompanied by a marked fall in the volume of investment. The demand for short-term credit decreases, and short-term rates of interest fall. This happened during the last economic depression. The short-term rates collapsed in 1931, and after 1933 sank below the long rate.² Thus throughout the depression long-term rates of interest and short-term rates were moving in opposite directions.

Since 1942 long-term rates of interest have been falling. Prices, including agricultural prices, have been steadily rising since 1942.

1. If the conditions under which our agriculturists live alter, an economic depression may have a different effect on long-term rates of interest. If the agriculturists are not deeply in debt, if the rate of assessment is reduced when agricultural prices fall, the long-term rate of interest need not rise even in a period of depression.

2. S. K. Muranjan, *op. cit.*, p. 52.

Indian agriculturists have benefited from this rise in prices. Land values have risen.¹ Many of the agriculturists have paid off their debts. Land-owners who are in need of long-term credit do not have much difficulty in getting it. The rates of interest on long-term loans have therefore fallen?² What about short-term rates of interest? Have they risen? They have

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1. I know from personal observation that in certain parts of the country the value of agricultural land has more than doubled.
 2. It is very difficult to trace the changes in the long-term rates of interest in India. Long-term loans are supplied mostly by private individuals, and it is difficult to find out the average rate of interest at any given time. But between 1934 and 1946 I noted a number of cases where long-term loans were supplied by private individuals. In these cases I could find out the rates of interest. I noted 12 cases between 1934 and 1943 and 10 cases between 1942 and 1946. The average rate of interest on long-term loans between 1934 and 1942 was about 5½ per cent. The average rate of interest on long-term loans between 1942 and 1946 was just 4 per cent. In 1934 I examined 10 landowners who had borrowed long-term loans before 1931. The average rate of interest in this case was about 5 per cent. Thus the rate of interest on long-term loans rose during the last economic depression and fell again in 1943. But I could study at first hand movements in interest rates in only the Udipi Taluk of South Kanara District. An attempt should be made to trace the changes in the long-term rates of interest since 1925 in other Taluks also. Then we can have some idea of the changes in the rates of interest on long-term loans during the period under review. But I have reason to believe that similar changes occurred in the long-term rates of interest in other parts of India also. The conditions in this respect in other parts of India cannot be greatly different from the conditions in Udipi Taluk. At least in other parts of the West Coast the conditions in this respect are exactly similar to those in the above-mentioned Taluk. I have not traced the changes in the rate of interest charged by land-mortgage banks. These do not affect the rates of interest charged by private individuals who lend on

fallen, as everybody knows. But I think this does not disprove the theory mentioned above, namely, that in India long-term rates of interest and short-term rates tend to move in opposite directions. There is at present a boom in many trades, but the boom is not general. There has been no remarkable increase in the volume of investment. Moreover, there has been inflation, and this has tended to reduce the rates of interest. If there had been a real boom in all the trades the short-term rates of interest would have risen. The war and inflation have been complicating factors. Normally, long-term rates of interest and short-term rates tend to move in opposite directions.

long term at present, because a very small proportion of the long-term loans borrowed by agriculturists are supplied by these institutions. Moreover, the rates of interest charged by land-mortgage banks are subject to peculiar influences. In 1940 the rates charged by the Provincial Land-Mortgage Bank and the primary land-mortgage banks in the Province of Bombay were raised by $\frac{1}{2}$ per cent (See the Annual Report of the Bombay Provincial Land-Mortgage Bank for 1940). It was difficult to raise long-term funds during this period of uncertainty. But the long term funds were raised by means of debentures. In a period of uncertainty investors cannot be keen on long-term investments. But even in a period of uncertainty people who have saved money and want to invest it on long-term will be willing to lend it to private individuals on the security of land. The rates of interest charged by land-mortgage banks had to be raised at a time when people could borrow long-term loans from private individuals at very low rates. See Appendix I.

One peculiarity about interest on long-term loans may here be noted. Although there is no long-term rate of interest which can be regarded as a standard rate, there are no great variations in long-term rates of interest. This cannot be said of short-term rates of interest. The rate of interest on short-term loans may vary from 3 to 300 per cent.¹ The Central Banking Enquiry Committee found that the maximum rate of interest on short-term loans in Provinces like Bengal and U. P. was as high as 300 per cent.² In the case of short-term rates of interest there are so many things which tend to broaden the margin of variation. The rate of interest on short-term loans depends mostly on the nature of the security offered by the borrower. Sometimes short-term loans are granted on personal security. Then the rate of interest will be pretty high. The rate of interest on short-term loans sometimes depends on the total amount of money which the particular lender is able to lend in the course of a year. A petty money-lender who

1. I know how some money-lenders who actually charge 300 per cent interest. They take from their borrowers 4 annas a month for every rupee lent. They lend only small sums of money. This works out at 300 per cent.

2. The Central Banking Enquiry Committee Report, para 112.

lends small sums of money cannot hope to make much money if he charges low rates of interest. His idea is to earn a living by lending out money at interest and he will have to charge fairly high rates of interest. Some money-lenders, again, try to take unfair advantage of the helplessness of the borrowers. They will charge exorbitant rates of interest. These are well-known facts. There is thus scope for great variation in the case of short-term rates of interest. But these causes of variation do not exist in the case of long-term rates of interest. Almost the same kind of security is offered in the case of all long-term loans. A long-term loan is borrowed on the security of a house or plot of land. Such security will be readily accepted by lenders in India. Says Dr. L. C. Jain, "The mortgage of house and landed property is readily acceptable as security. The rate of interest on a usufructuary mortgage is seldom more than 9 per cent".¹ Long-term credit is provided either by special credit institutions or by individuals who are not professional money-lenders.² The rate of interest charged by these has nothing to do with the total amount lent in the course of the year. They charge

1. See Dr. L. C. Jain, "Indigenous Banking in India", (1929 Ed.), p. 95.

2. See below, Chap. V, Sect. 1.

the same rate of interest whatever the total amount lent in a year. Lastly, those who provide long-term credit cannot take unfair advantage of the ignorance of the borrowers. Long-term loans are almost always mortgage-loans, and the mortgage-bonds have to be registered. Moreover, those who borrow long-term loans are usually men of substance who own immovable property. Such men do not allow themselves to be exploited. Thus, from the very nature of the case, there cannot be great variations in long-term rates of interest.

It is much easier to regulate the rate of interest on long-term loans than the rates of interest on short-term loans. The reason is obvious. Although the people who lend money for long periods do not charge a uniform rate of interest, there are no great variations in the rate of interest. Now the rates of interest must be fixed with due regard to the market rate. In the case of interest on short-term loans it is almost impossible to find out the market rate. As already said, the rate of interest may vary from 3 to 300 per cent. There is no long-term rate of interest which can be called the market rate, but still it is possible to select some rate which will satisfy

both borrowers and lenders. After all, there cannot be very great difference between one long-term rate of interest and another.

There is another reason why it is much easier to regulate the long-term rate of interest. If the rate of interest on long-term loans is legally fixed, the law regarding the rate of interest cannot be easily evaded. A man who borrows a long-term loan is not at the mercy of the lender, when once the loan is borrowed. The creditor cannot claim his money before the loan is due and the loan will not be due for a pretty long time. So every year the borrower will pay interest at a rate fixed by the Government. Of course, there is one way of evading the law. The lender can demand from the borrower in advance the difference between the total interest according to the rate which he expects and the total interest according to the rate legally fixed. But this is not possible in the case of a long-term loan. Suppose a man wishes to borrow Rs. 3000/- on the security of his estate. If the legal rate is 5 per cent and if the lender expects 8 per cent interest, and if the period of the loan is 12 years, the lender must take from the borrower Rs. 1080/- in advance. That is the difference between the total interest according to the

rate of interest demanded by the lender and the total interest according to the rate fixed by the Government. The lender must get the sum of Rs. 1080/- in a lump in advance. The borrower will not care for him when once the money is lent to him, and will every year insist on paying interest at the legal rate. But can the lender expect to receive from the borrower in advance Rs. 1080/- when the amount to be lent is only Rs. 3000/-? Surely not. It is easy to see that the law regarding the rate of interest can be evaded in the case of short-term loans. Suppose a man wants to borrow Rs. 1000/- for one year. If the legal rate of interest on short-term loans is 6 per cent and if the lender expects 10 per cent interest, the borrower may pay the difference to him in advance, if he badly wants the money. The difference comes to Rs. 40/-. Thus the law regarding the rate of interest can be evaded.¹

Thus the rate of interest on long-term loans can be legally fixed, without greatly interfering with the law of demand and supply.

1. But in spite of this and in spite of the fact that there are very great variations in the rate of interest on short-term loans, the rate of interest on short-term loans is legally fixed in many provinces (See Jathar and Beri, "Indian Economics", Vol. I, 1942 ed., pp. 298-299). We must admire the bold policy adopted by these Provincial Governments. Whether the measures adopted by them have succeeded is a different matter.

Also, any measures that the Government may adopt in this connection can be enforced. As we have seen, the law regarding the long-term rate of interest cannot be easily evaded. There is no reason why the rate of interest on long-term loans should not be legally fixed in this country. Even Adam Smith, a staunch advocate of individualism and "laissez-faire", thought that the rate of interest should be legally fixed, with due regard to the market rate¹. Our agriculturists are greatly in need of long-term credit. One of the best ways of improving their economic position is to provide them with long-term loans on easy terms. So far as I know, no attempt has been made to regulate the long-term rate of interest as distinct from the short-term rate of interest. But the long-term rate of interest may, and usually does, differ from the short-term rate. The market for long-term credit is not the same as the market for short-term credit. There is thus no point in prescribing the same rate of interest in the case of all classes of loans. But this is what has been done in those provinces where an attempt has been made to regulate the rate of interest. Of course, in all the provinces except Madras a distinction is made between

1. Adam Smith, "The Wealth of Nations", (published by Routledge and Sons, Ltd.), p. 275.

secured and unsecured loans. The rate of interest is lower in the case of secured loans.¹ But secured loans are not necessarily long-term loans. Even if a secured loan is a long-term loan, the rate of interest on it should not be lower simply because it is secured by a mortgage. The rate of interest on long-term loans depends on the structure of the market, and may be higher or lower than the rate of interest on short-term loans.

5

Before leaving this subject of interest, I may say a few words about that interesting principle, the principle of damdupat. The principle applies only in the case of long-term loans. It has been variously interpreted. The most authoritative exposition of the principle is found in "Principles of Hindu Law" by the late Mr. D. F. Mulla. The principle of damdupat is a branch of the Hindu law of debts. According to this principle, the amount of interest recoverable at any time cannot exceed the principal.² It is clear that the principle ordinarily applies only to interest on long-term loans.³ In the case of such loans

1. See Jathar and Beri "Indian Economics", Vol. I, (1942 Ed.), pp. 298-299.

2. D. F. Mulla, "Principles of Hindu Law", (6th Ed.), p. 596.

3. In the case of short-term loans the interest cannot accumulate till it exceeds the principal.

interest cannot accumulate without limit. The higher the rate of interest, the sooner the limit is reached. This principle was generally observed in pre-British days.¹ Even today it is observed in some parts of the country. It applies, for instance, in the Bombay Presidency.²

I may in this connection refer to a novel interpretation of the principle of *damdupat*. Section 8 (3) of the Madras Agriculturists' Relief Act of 1938 reads: "Where the sums repaid by way of principal or interest or both fall short of twice the amount of the principal, such amount only as would make up this shortage, or the principal amount or such portion of the principal amount as is outstanding, whichever is smaller, shall be repayable". This is how the principle of *damdupat* has been interpreted.³ It is doubtful whether the framers of the Madras Agriculturists' Relief Act had considered the implications of the principle of *damdupat* as interpreted by them. The principle may not directly affect the supply of long-term credit,

1. Jathar and Beri, "Indian Economics", Vo. I, (7th Ed.), p. 287.

2. D. F. Mulla, *op. cit.*, p. 598.

3. This is referred to as the principle of *damdupat* in para 4 of the Report of the Joint-Select Committee appointed to consider the Madras Agriculturists' Relief Bill of 1937.

but long-term loans for more than a certain number of years will be impossible. An example will make this clear. Suppose a man lends Rs. 1000/-, charging 10 per cent interest. At the end of 10 years he receives from the debtor by way of interest an amount which equals the amount lent. The maximum amount which he can get from the debtor is Rs. 2000/-, if the principle of *damdupat* as interpreted by the framers of the above-mentioned Act is applied. This means that after 10 years the utmost that the creditor can get is Rs. 1000/-. (He has already received Rs. 1000/- by way of interest). This means that he will get back only the principal. Then why should he not recover the money at the end of ten years and lend it to some other man? It will be a fresh loan and he will get interest on the money lent. If the rate of interest on long-term loans is 10 per cent and if this new principle of *damdupat* is applied, no person will be willing to lend money for more than 10 years. This is clearly a disadvantage, and persons who are in need of loans for periods exceeding 10 years will suffer. It is only fair to add that in Madras the so-called principle of *damdupat* applies only to debts incurred before 1932.¹ So

1. See Section 8 of the Madras Agriculturists' Relief Act of 1938.

it does not affect persons who have been lending long-term loans since 1932. But the debts which are contracted now may be compulsorily scaled down and this principle of *damdupat* may be applied once again. To be on the safer side, creditors will not lend for more than a certain number of years. The length of the period will depend on the rate of interest. If the rate of interest is $6\frac{1}{4}$ per cent, a man will not lend for more than 16 years. For he will not get any interest after 16 years if this principle of *damdupat* comes to be applied. Ordinarily, the prospect of compulsory scaling down of debts at some time in the future will not affect the supply of long-term loans¹. A certain class of lenders cannot help lending on long term. But they can be particular about the period for which the money is lent. They will not lend money for more than a certain number of years, if there is any danger of this new principle of *damdupat* being applied.

NOTE TO CHAPTER III

In this note some of the points raised in Chapter III will be further discussed.

In Chapter III, Section 2, it has been said that short-term rates of interest and long-term rates of interest often move in opposite directions, but that since 1942 both the

1. See below, Chap. IV, Sect. 4.

long-term and short-term rates of interest have been falling. There is, however, evidence to show that since December 1946 the short-term rate of interest has slightly risen. Of late the short-term money market in India has become somewhat tight. Most commercial banks charge slightly higher rates of interest. At present it is difficult to say whether there will be a permanent increase in the short-term rates of interest. There is bound to be a permanent increase in these rates if the volume of production increases, and if goods are imported into this country more freely. But the long-term rate of interest has not risen; it will not rise so long as the present boom in agriculture lasts. The short and long rates may once again move in opposite directions.

It must be remembered that the theory enunciated in Chapter III, Section 3 is valid only under the particular conditions prevailing in this country. If the conditions change, the theory will no longer be valid. The theory does not hold good in many Western countries. In England, for instance, there is a tendency for short and long rates to move in the same direction.¹ In that country a movement in short-term rates of interest is bound to be followed by a movement, *in the same direction*, in long-term rates of interest. Suppose the short-term rate of interest rises. Individuals and firms in need of capital will try to obtain the necessary capital by selling their securities. With a part of the proceeds from the sale of the securities they may repay any loans they may have borrowed from the banks. The demand for short-term loans decreases. It is because the short-term rate of interest has risen relatively to the yield on long-term securities. Again, individuals and firms holding surplus funds may keep back a part of their

1. See Prof. J. R. Hicks, "Value and Capital", (1939), p. 152.

surplus funds in the form of deposits. Thus the demand for securities decreases. At the same time more securities are offered for sale. All this tends to lower the prices of securities. When the prices of securities fall, the yield rises. Thus the long-term rate of investment, as distinguished from the long-term rate of interest, rises. But in England the long-term rate of investment is related to the long-term rate of interest. So any one wanting to borrow for a long time must pay a high rate of interest. A rise in the short-term rate of interest eventually leads to a rise in the long-term rate of interest. Mr. R. S. Sayers has shown how the effective long-term rate of interest rises when the official Bank Rate is raised.¹

In England the short and long rates of interest move in the same direction because the long rate bears some relation to the short rate. The long-term rate of interest is *higher* than the short-term rate. The lenders in England feel that there is greater risk in lending for long periods, and that lending for long periods involves greater sacrifice. But the long rate is directly related to the short rate. As Professor Hicks has pointed out², if short rates are not expected to change, the long rate will exceed the short rate by a normal risk premium. Compare this with the position in India. Here the long-term rate of interest does not depend on the short-term rate. And usually it is lower than the short-term rate.³

CHAPTER IV

THE PROBLEMS OF LONG-TERM CREDIT

1

Reference has been made to the fact that long-term loans are generally mortgage loans.

1. See R. S. Sayers, "Modern Banking", (1938), pp. 151-152.

2. See Prof. Hicks, *opp. cit.*, p. 147.

3. See above, Ch III, Sect. 2.

There cannot be long-term loans without proper security. In theory, the thing which is offered as security for a long-term loan need not be necessarily some form of immovable property. It may be anything, so long as it satisfies certain conditions. It must be durable, it should not be easily lost or destroyed, its value should not be subject to sudden fluctuations, and it should be capable of being used by the borrower even during the currency of the loan.¹ At present, however, the only thing which is offered as security for a long-term loan is some kind of immovable property. Now in any given place the number of persons who cannot offer any immovable property as security must be very large. These persons cannot afford to borrow at long term from others. Often those who are most in need of long-term credit do not obtain it, as they have no security to offer. But some of them may be badly in need of long-term credit. The substitution of short- for long-term loans creates all sorts of complications.² Thus the problem of security is one of the greatest problems of long-term credit. Is it possible to discover a substitute for immovable property?

1. See above, Chap. I, Sect. 4.

2. See above, Chap. II, Sect. 7.

As everyman familiar with modern banking knows, banks are often willing to grant advances to customers on the security of what are known as stock exchange securities. In England the most common form of security deposited by a customer consists of stock exchange securities, such as share certificates and bearer bonds¹. Can these be offered as security for long-term loans? It is clear that the lender cannot accept all sorts of securities. The value of certain securities may fall. This danger is negligible if the period of the loan is very short. But a man who supplies advances for long periods will expect particular kinds of securities, if at all he is willing to make long-term advances on the security of stock exchange securities. He will probably accept what are known as gilt-edged securities. These satisfy all the above-mentioned conditions. The question is, will the borrower be in a position to offer such security? Of course, those who own gilt-edged securities can borrow long-term loans on the security of these things, if they are in need of long-term loans. But this kind of security will be rarely offered by a man who is in need of a long-term loan. He will raise the money by selling his securities

1. Evelyn Thomas, "Banker and Customer", (1926), p. 570.

rather than by borrowing a long-term loan on the security of these securities. He will be saved much trouble. Not only that. He may be put to some loss if he keeps the securities and borrows a long-term loan on the security of these, for the percentage yield on money invested in gilt-edged securities may be and generally is lower than the percentage yield on money which is lent for long periods on proper security. He will, however, keep the securities and borrow a long-term loan on the security of these, if he knows for certain that there will be a great rise in the value of the securities at the end of the period for which the loan is made. But in no case can he be so sure. Stock exchange securities, therefore, cannot be offered as security for long-term loans.

There is only one possible substitute for immovable property. A bank or a private individual may, in certain cases, make long-term advances on the security of a life policy on the life of the borrower. This idea is not new. It has been discussed before. But it has not been given a fair trial, nor has it been worked out.

Opinion on this subject is divided. The Late Mr. V. Ramadas Pantulu, who was for some years the Editor of "The Indian

Co-operative Review” and was regarded as an authority on co-operation, insurance and credit believed that it was not possible under any circumstances to lend money for long periods on the security of life policies. This is what he wrote on the subject: “A credit institution which holds as security an insurance policy of the borrower cannot possibly raise long-term funds in the money market for making long-term advances on the security of such policy. Moreover, the borrower may commit default in respect of payment of premia on his policy, to the insurance company, in which case either the policy lapses or at the most will acquire the paid up value if he has made the requisite number of payments before the lapse”.¹

In England commercial banks frequently accept life policies as cover for temporary loans². But no credit institutions are prepared to grant long-term advances against this form of security. Let us see whether a life policy can be accepted as security for a long-term loan. In theory a life policy satisfies all the conditions mentioned in Chapter 1, Section 4. It has one additional advantage; its value

1. From a memorandum which the late Mr. V. Ramadas Pantulu prepared for me.

2. Evelyn Thomas, *op. cit.*, p. 602.

will never fall. On the contrary, it will increase at the end of the period for which the loan is made, if bonuses are paid. But a bank lending money for a long period on the security of a life policy must take certain precautions. It must take from the borrower a full legal assignment of the policy. The deed of assignment conveys the policy to the lender by way of mortgage, and embodies an undertaking by the assignor to pay the premiums punctually and to lodge the receipt with the bank. In case of default the bank must have the right to sue the whole amount due, whether the loan is due for repayment or not. The bank must also have the power to pay the premiums and to debit their amount to the assignee's account in case the premiums are not punctually paid. It is clear that an endowment policy is preferable to a whole life policy, for the former is payable at the expiration of a certain number of years, or on the previous death of the assured¹.

But the disadvantages are great. Even when all possible precautions are taken many difficulties will arise. Some of these difficulties are inherent in the nature of the security. The insurance company may avoid its liability

1. Evelyn Thomas, *op. cit.*, p. 602.

if it can show that some of the statements made by the assured when he applied for assurance are not true, or that any material information has been withheld. The company may avoid its liability in certain other cases too, for instance in cases where the assured commits suicide. But the greatest difficulty arises in connection with the payment of premiums¹. The policy must be maintained in force if it is to have any value as security for the money advanced to the borrower. The borrower must pay the premiums as they fall due. The bank may advance the premiums as they fall due, but this is no solution of the problem, because the bank will be in that case merely adding to the amount already advanced².

It would be foolish to minimise this difficulty, but this difficulty is not so great as some people imagine. Nor does it persist throughout the period of the loan. Suppose the long-term loan which is borrowed on the security of the life policy is to be repaid by

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1. This difficulty does not arise when a life policy is accepted as security for a short-term loan.
 2. Mr. Evelyn Thomas discusses at some length the suitability of this kind of security in his book, "Banker and Customer", pp. 602 and 603. My discussion of this subject is partly based on his. But I am discussing the suitability of this kind of security from the point of view of the bank which makes long-term advances.

instalments. As time goes on the surrender value of the policy will increase. At the same time the amount which the debtor owes to the bank diminishes. If the loan runs for 20 years, at the end of 10 years the surrender value of the policy will be equal to the amount which the borrower owes, if we assume that the sum assured is equal to the sum borrowed. Thereafter, the bank need not generally bother about the payment of premiums. The surrender value of the policy may be regarded as adequate security. Thus the difficulty about premiums does not persist throughout the period of the loan. It exists only during half this period. This does not occur to many people who are interested in this subject.

If the period of a long-term loan borrowed on the security of a life policy is 20 years, the regular payment of premiums must be insisted upon during the first 10 years. This may present a difficult problem. But it may not be a very serious problem. Most insurance companies have introduced the non-forfeiture system. After the requisite number of premiums are paid, a company will for some years automatically advance the premiums as they fall due and maintain the policy in force. Such advances together with interest may be

repaid at any time while the policy is so kept in force. After the requisite number of premiums are paid, a policy will not lapse even though some premiums are not paid. If the policy becomes a claim during this period, the claim will be entertained, but the money advanced by the company together with interest thereon will be deducted from the amount due from the company. Of course, the company will advance the premiums and keep the policy in force only so long as there is sufficient net surrender value to cover these advances and interest thereon.¹ The non-forfeiture system is a great advantage from the point of view of the credit institution which makes long-term advances on the security of life policies.

A life policy, then, may be accepted as security for a long-term loan. The practical side of this question will be fully discussed in Chapter VII, Section 1. In this section I have simply tried to suggest a solution for the problem referred to at the beginning, namely, the problem of providing proper security for long-term loans. But it cannot be thought of as a normal kind of security for long-term

1. See the Non-Forfeiture Regulations of the Oriental Life Insurance Company. These are clearly stated in the policy issued to every policyholder.

loans. We must guard against the indiscriminate use of this form of security. It is only in exceptional cases that a life policy can be accepted as security for a long-term loan. The man who borrows a long-term loan on the security of a life policy must be able to pay every year a part of the principal as well as the premiums for the year. It is only a person with a large and steady income who can pay these regularly.

There are certain persons to whom money can be lent for long periods on the security of life policies. They are persons who have well-paid and permanent jobs in Government service, or in the service of some reputable and long-established firm. In the case of certain religious institutions also a life policy can be accepted as security for a long-term loan. Some religious institutions like mutts cannot, under the existing law, raise long-term loans on the security of their immovable property. This often proves a handicap. Many of these religious institutions are deeply in debt, and they have to pay high rates of interest on the loans they have borrowed. These are necessarily short-term loans. Of course, the loans are renewed again and again. Because of the high rates of interest they

have to pay, they are not able to clear themselves of debt. They should be in a position to obtain long-term loans on the security of life insurance policies. This will solve their problem. A credit institution which provides long-term credit can, without very great risk, lend money for long periods to the head of a mutt (who is also a religious head) on the security of a life policy. The mutt, which may be assumed to enjoy a large yearly income, should not have much difficulty in paying every year interest on the loan, a part of the principal and the premiums for the year. The debt may not be legally binding on the successor of the borrower. But in the event of the borrower's death the credit institution which has advanced the money can dispose of the policy in satisfaction of its claim.

2

As already stated, the provision of proper security is one of the problems of long-term credit. So nothing should be done to complicate this problem. But certain measures adopted by Government in the past have tended to complicate this problem. They have reduced the security which a certain

class of people can offer for long-term loans. But these measures may be justified on other grounds. Here is a difficult problem indeed. The statutory restrictions on the alienation of agricultural lands in certain parts of India have given rise to a problem of this kind. The Panjab Land Alienation Act was passed in 1901. The Act prohibits agricultural land from passing into the hands of the non-agricultural classes¹. The object of the Act is to prevent money-lenders from obtaining possession of their debtors' land. This was subsequently copied in Oudh, Bundelkand, and Bombay. The Oudh Settled Estates Act, 1900, the Bundelkand Alienation of Land Act, 1903, the Bombay Act of 1901 had a similar object.² This type of legislation has not been very effective in the Punjab and elsewhere. As Mr. Calvert says, it has merely encouraged the agriculturist money-lenders as against the trading usurer.³ But this particular defect has been remedied in the Punjab. One of the amendments made to the Punjab Land Alienation Act in 1938 aims at the inclusion of agriculturist money-lenders in the same

1. Dr. Vera Anstey, "The Economic Development of India", (1929) p. 189.

2. *Ibid.*, p. 108.

3. Mr. H. Calvert, "Wealth and Welfare of the Punjab", p. 142.

category as non-agriculturist money-lenders.¹ But everywhere the restrictions on the alienation of land have adversely affected the agricultural classes.

They have produced unexpected evils. Measures like the Punjab Land Alienation Act have the effect of restricting long-term credit. An agriculturist who cannot mortgage his land to a money-lender has no means of obtaining long-term credit, for immovable property like agricultural land is the only thing that will be accepted as security in the case of long-term loans. The Indian Central Banking Enquiry Committee was aware of this difficulty. The Committee said that "the double object of preventing the free mortgage and sale of agricultural land and the provision of credit for the economic benefit of the agriculturists through the co-operative land-mortgage banks cannot be easily achieved."² In the Panjab the Land Alienation Act has proved a serious impediment to the growth of land-mortgage banks.³

Of course, land which is cultivated by peasant-proprietors should not pass to professional money-lenders, or non-cultivating land-

1. Jathar and Beri, "Indian Economics", Vol. I, (1942 Ed.), p. 311.

2. Report of the Central Banking Enquiry Committee, para 176.

3. "Economic Problems of Modern India", Ed. Radhakamal Mukerjee, Vol. I, (1939), Chap. X, p. 194.

owners. Tenancy farming can never be very efficient. But many so-called agriculturists do not cultivate the land which they own. Even in ryotwari areas, many ryots let out their lands to others. In such cases changes in the ownership of land may not be detrimental to agricultural efficiency. On the contrary a few such changes here and there may be desirable. I have found that some non-agriculturists who invest their money in land make better landlords than landlords who have been always agriculturists. They take greater interest in their land, and believe in making permanent improvements to their land. In certain cases the infusion of new blood may benefit the agricultural community.

In future the alienation of agricultural land will not be a serious problem. The alienation of agricultural land by the owners thereof need not be an evil so long as the actual tillers of the soil have fixity of tenure. If they have fixity of tenure and if rents are regulated by the state, changes in the ownership of land will not be detrimental to agricultural efficiency. It is not too much to hope that in future the actual tillers of the soil will have a right of occupancy, whatever land systems may prevail. If this and certain other

rights are conferred upon the people who actually cultivate the land, statutory restrictions on the alienation of land will lose their significance.

3

Restrictions on the alienation of land may serve some other purpose. As we have seen, restrictions on the alienation of land are in effect restrictions on borrowing. An agriculturist who cannot alienate his land will find it extremely difficult to obtain a long-term loan. This may not be altogether undesirable. This brings us to another important problem. Is it desirable to limit, directly or indirectly, the supply of long-term credit? This problem does not arise in connection with short-term credit. But a long-term loan may create all sorts of complications and may ultimately result in bankruptcy. Much, of course, depends on the method of repayment and certain other things.¹ In India long-term debts have been accumulating for the last so many years. The passing of the Registration of Documents Act (1864) and the Transfer of Property Act (1882) has led to the growth of mortgages in number and value. One way of preventing

1. See above, Chap. 1, Sect. 3.

the accumulation of long-term debts is to place restrictions on the transfer of land. These restrictions will reduce the security which agriculturists can offer and will result in fewer long-term loans. The State may adopt measures which aim at the exemption of holdings below a minimum size from seizure for debts. In this case many of the smaller landowners will not be able to borrow long-term loans freely, for measures of the kind mentioned above will reduce the security which landowners can offer.

But such measures do more harm than good. Long-term loans, by themselves, are not harmful to the agriculturists. Much depends on the purpose for which they are borrowed. No harm will result from long-term loans which are borrowed for productive purposes. On the contrary, they will be of the greatest benefit to the borrowers. But the long-term loans which are borrowed must be repaid at the proper time. This need not be a great problem, for productive debt creates its own means of repayment. The proportion of cultivated land mortgaged in India is considerably below that for England, or France.¹ This is reassuring. Measures

1. "Indian Co-operative Studies", ed. R. W. M. Ewbank. Quoted by Dr. Vera Anstey in "The Economic Development of India", (1929), p. 187.

which tend to limit the demand for long-term credit by reducing the security which borrowers can offer cannot be justified.

4

We come now to the greatest problem of long-term credit. This problem very rarely arises in connection with short-term debts. The greatest problem in connection with long-term loans is the problem created by changes in the level of prices. The level of prices in any country cannot be expected to remain the same through the period involved in long-term debts. There have been frequent changes in the level of prices in all countries. We may leave out of account extreme variations in purchasing power, such as those which characterised the German mark and the Russian ruble after the last Great War. Such cases need not arise. But changes great and small occur in the level of prices. The last economic depression brought about a great change in the level of prices. Everybody remembers the recent world slump in prices. In 1929 there was a tremendous crash on the New York Stock Exchange and thereafter a swift recession in prices, which spread throughout the world. There has been a great

rise in prices in this country since 1942. A fall in prices causes great hardship to people who have borrowed long-term loans. They have to pay back more than what they received, even though the amount of the principal remains the same. A fall in prices increases the burden of debt. Money as a standard of deferred payments has this defect. But this defect is not felt by those who deal in short-term credit. There cannot be any great change in the level of prices during the period involved in short-term loans.

Is there any solution of this problem? Obviously, the best thing would be to prevent changes in the level of prices. But this is easier said than done. Those who have studied the working of the various currency systems know how difficult this is. Even today many believe that if a country is on the full gold standard there will not be great or sudden changes in the level of prices. Under this system of currency, the level of prices is affected by changes in the output of gold. Therefore, the level of prices may rise or fall. But the general movements in prices that follow upon changes in the output of gold usually take the form of steady trends upward or downward through fairly long periods of time. This is doubtless an advantage. But

even when a currency rests on gold, there may be great and sudden changes in the level of prices.¹ There was a sharp rise in all prices in the United States during the War of 1914-18, although the currency rested on gold. The explanation is not far to seek. In modern times, so far as prices are concerned, credit exercises a more direct influence than gold. All of which goes to show that the gold standard as a standard of deferred payments cannot be relied upon. Professor Irving Fisher has suggested an ingenious way of eliminating general price changes. He believes that the dollar might be "stabilized" by making the real monetary standard a variable amount of gold bullion. The plan could be so operated as to eliminate changes in the general level of prices. But this will cause fluctuations in the price of foreign exchange and in the domestic prices of imported goods. Moreover, this is a round-about way of dealing with fluctuations in the general level of prices. We know that the most harmful fluctuations come from inflation or from the expansion or contraction of bank credit.²

Many people have no faith in the gold standard. Some among these believe in a

1. Taussig, "Principles of Economics", (1938 ed.), Vol. I, pp. 104-105.

2. Prof. Irving Fisher has set forth his ideas in his book, "Stabilising the Dollar", and his ideas are well known to all students of Economics, having been stated and discussed in some standard books on Economics.

managed currency. If we have a managed currency we can make the level of prices remain constant. That is what many people believe. The subject has been discussed by professional economists as well as laymen interested in economic reconstruction. It has attracted the attention of writers like Mr. H. G. Wells. To economists of the New Money School a managed currency is the ideal. A managed circulation of money would maintain the index number at a constant level. The issuing authorities must be constantly watching price movements. If they expect a rise in prices they should make money dear and restrict bank credit. If they expect prices to fall, they should make money cheap and credit plentiful. To Mr. H. G. Wells the system appears to be so simple. He advocates a managed currency in his book, "The Work, Wealth and Happiness of Mankind". He says that we have introduced a complication into a relatively simple matter. The issue of money in most countries is directly related to the amount of gold stored in certain national banks and treasuries.¹ But the system of currency advocated by Mr. H. G. Wells should not be regarded as utopian. Lord Keynes, one

1. H. G. Wells, "The Work, Wealth and Happiness of Mankind", (1934 ed.), pp. 353-354.

of the most eminent economists and an economist who never loses touch with reality, regards this system of currency as the only scientific system of currency. He is indeed the greatest exponent of the New Money ideas. These ideas are set forth in "A tract on Monetary Reform" (1923), and "A Treatise on Money" (1931). In theory there is nothing wrong in a barometric currency based on an index number. But there are some practical difficulties. As we shall presently see, an index number may not give us a correct and exact idea of the changes in the level of prices. There is another difficulty. Prices are related to incomes. The level of prices cannot remain the same if there are changes in incomes and the volume of employment. It is now generally believed that price stability does not ensure stability of income and employment. In fact it cannot be achieved in the long run except through stable income and employment. Such has been the experience of the leading countries of the world.¹

It is humanly possible to achieve a stable currency. But do we always want a stable currency? Those who control the supply of money in a State are not

1. "International Currency Experience" (published by the League of Nations in 1944), p. 231.

always actuated by monetary considerations. A country will often try to correct an adverse balance of payments by manipulating the exchange rate and the currency. As Mr. Clarence K. Streit says, "It is the swiftest, most sweeping and high-powered, the clumsiest, blindest, and most incalculable of the economic weapons in the arsenal of the State. It acts as a tariff on all imports,—except that it brings the Government no revenue—combined with a subsidy to all exports."¹ The problem of monetary stabilization is thus bound up with other problems. To quote Mr. Clarence Streit again, "It is not strange that the problem of monetary stabilization has grown worse under managed nationalism and has given birth to such costly nonsense about silver and gold and paper and internal price levels and deflation, inflation, reflation, and such hen-or-egg debates as that over which comes first, monetary stabilization or tariff reduction. It would be strange, however, for this monetary problem to be solved enduringly without the world economic problem, the world armaments security problem and, above all, the world government problem, being solved at the same time."²

1. Clarence K. Streit, "Union Now", (1939 Ed.), p. 223.

2. Ibid, pp. 223-224.

Monetary stabilization cannot be thought of for many years to come. Changes in the level of prices must be taken for granted. But is it not possible to relate dealings in long-term credit to the purchasing power of money? In theory it is. In the case of a long-term loan, the amount to be repaid must be related to the level of prices prevailing at the time of repayment. If prices fall by 50 per cent, only half the amount originally borrowed need be paid. The level of prices at any time will be indicated by the index number. It is thus possible to have a tabular standard of deferred payments. It is interesting to note that such a standard has been actually tried. Massachusetts in 1742 provided that for use in the payment of debts her colonial bills of credit should be periodically re-valued in accordance with the price of silver and of bills of exchange. Five years later it was enacted that the prices of certain necessaries of life should also be taken into account.¹

But a tabular standard of value may not work in practice. It presupposes an index number which can be wholly relied upon.

1. W. C. Fisher, "The Tabular Standard in Massachusetts History", *Quarterly Journal of Economics* (May 1913), Vol. XVII, pp. 417-451. Quoted in "Outlines of Economics" by Dr. Richard T. Ely and others, 5th ed., p. 319.

Even a properly constructed index number may not be very reliable. It may not give us a correct and exact idea of changes in the level of prices. By means of an index number we can measure changes in the purchasing power of money to certain classes of consumers. But we cannot measure accurately changes in the general price level. An index number will not record the net or average change in rents, wages, salaries and security prices of all kinds. Then, again, changes in "sectional price-levels" are not taken into account. There are still greater difficulties. The real difficulty is often referred to as "the index number problem" and, as every student of Economics knows, this is a very serious problem. An index number has essential limitations. All things considered, it is highly undesirable to introduce a tabular standard of deferred payments.

Any attempt to eliminate changes in the general level of prices is bound to end in failure. At the same time a tabular standard of deferred payments is not to be thought of. What, then, is to be done? There is no cause for despair. We should not bother about changes in the purchasing power of money. I do not suggest that we should give up all idea

of preventing changes in the level of prices. A stable currency should be our ideal. So far as long-term loans are concerned, the problem created by changes in the purchasing power of money can be solved even if we do not make any attempt to prevent such changes. If we cannot eliminate changes in the general level of prices, we can mitigate the hardship caused by such changes to people who lend and borrow long-term loans. The loss to lenders and borrowers can be minimized if the repayment of long-term loans is spread over a sufficiently long period, say, 20 years. The general movements in prices usually take the form of steady trends upward or downward through fairly long periods. The repayment of long-term loans by instalments affords some protection against loss from price changes. Suppose a man borrows a loan repayable after 20 years and suppose prices are steadily falling. The borrower will surely lose, he has to repay at the end of 20 years the same sum of money, although the purchasing power of money at the end of 20 years will be very much greater. But his loss will be considerably less if he repays by instalments. This is quite obvious. A man who lends a long-term loan will lose if prices are rising during the

currency of the loan. But his loss will be much less if he receives every year a part of the principal. The risks occasioned by changes in the purchasing power of money can be reduced to the minimum by spreading the repayment of long-term loans over sufficiently long periods. We have seen how necessary it is that long-term loans should be repaid by instalments.¹ Here is one more reason for adopting this method of repayment.

So far, so good. But a difficulty arises when there is a great and sudden change in the level of prices. Such changes have occurred in the past. There was a tremendous crash in the world price level a few years after the last Great War. In Great Britain the highest point in the rise was reached in April, 1920. The index number of prices was 313, as compared with 100 in 1913. In September 1923, it was 150.² All debts practically doubled in burden. There was a similar fall in prices in most of the important commercial countries. Similarly there may be a great and sudden rise in the prices of all commodities. This has recently happened in India. The rise in prices in India has not been continuous and

1. See above, Chap. I, Sect. 3.

2. J. P. Dey, "Introduction to World Economic History since the Great War," pp. 46-47.

uniform since the outbreak of the present war. It became serious after April, 1942. The Calcutta Index Number of Wholesale Prices stood at 100 in 1939-40. In 1942-43 it was 211. The Bombay Index Number of Wholesale Prices stood at 103 in 1939-40. In 1942-43 it was 251.¹ The repayment of long-term loans by instalments does not afford any protection against great and rapid changes in the level of prices. A man borrows a long loan and at the end of the first year of the loan there is a great and sudden change in the purchasing power of money. Even though the loan is repaid by instalments, the borrower will incur a heavy loss. A very large part of the principal has to be repaid during the period when the purchasing power of money is very great.

What is to be done in such cases? In all such cases it will be necessary to adopt some scheme of debt relief. All debts contracted before a certain date must be scaled down, and the scaled-down debts must be made repayable by instalments. Borrowers who have repaid a very large part of the principal before the fall occurs are not in need of any

1. These figures from the Bombay and Calcutta Index Number of Wholesale Prices are quoted in Dr. V. K. R. V. Rao's book, 'War and Indian Economy', (1943), p. 160.

relief. For instance, a borrower of a long-term loan who has paid more than 75 per cent of the principal when the sudden fall in prices occurs may not be in need of relief. His loss will not be very great if the sudden fall in prices occurs during the middle of the period; it will be negligible if it occurs at the end of the period. But the loss will be very great if the fall occurs at the very beginning. Whenever there is a slump in prices even Governments find it difficult to repay in full the long-term debts which they contracted before the slump. Soon after the first slump in prices after the last Great War, most Governments were driven to write down debts. But they chose the method of devaluation, keeping the name of the monetary unit and the nominal figure of the debt, while reducing the value of the unit in terms of gold.¹

There are different methods of scaling down debts. A discussion of this subject falls outside the scope of this treatise. But a few words may be said on this subject, especially as the way in which the debts are scaled down may indirectly affect the supply of long-term credit. It will be generally agreed that debts cannot be scaled down without compulsion.

1. J. P. Dey, *op. cit.*, p. 51.

Debt conciliation may be one of the recognized methods of scaling down debts. Conciliation has been tried in most parts of India.¹ But conciliation is a slow and tedious process. It is extremely doubtful whether it is possible to scale down all debts which have to be scaled down by means of conciliation and other voluntary methods. Conciliation was tried in Madras for some time. But evidently it failed. The Madras Agriculturists' Relief Act provides for the compulsory scaling down of debts. A distinction is made between pre-depression and post-depression debts. It is only debts contracted before 1932 that are to be scaled down. This is only proper. All debts contracted before 1932 are to be compulsorily scaled down.²

It is believed by some that the compulsory scaling down of debts will have consequences which are not desirable from the point of view of those who are in need of long-term credit. If the debts are to be scaled down whenever there is a great and sudden fall in prices, persons who lend money for long periods cannot be sure of getting back what they have lent. This, it is said, will affect the supply of long-term credit. Very few people

1. Jathar and Beri, "Indian Economics", Vol. I. (1942 ed.), p. 301.

2. See Section 8 of the Madras Agriculturists' Relief Act.

will be willing to lend money for long periods. If this is true, it may be regarded as one of the problems of long-term credit. But is it true? Even repudiation of debts on the part of certain Governments has not deterred people from lending to these Governments once again. Old memories of repudiation may grow faint, new lenders may be forthcoming. Mr. Hugh Dalton, an authority on Public Finance, says, "It is not obvious, nearly twenty years after the event that, on a long view, the Soviet Government was not wise in its early repudiations."¹ Nobody wants repudiation. I mention all this to show that the compulsory scaling down of debts need not affect the supply of long-term credit. The Madras Agriculturists' Relief Bill was severely criticised by many legislators and publicists when it was being discussed in the Provincial Legislature. It was said that compulsory scaling down of debts would stop all credit in rural areas. But the Madras Agriculturists' Relief Act does not seem to have produced any such result. It has never been very difficult for a man who can offer proper security to get long-term loans on reasonable terms. Lenders do not bother so long as they

1. Hugh Dalton, *Op. cit.*, p. 26.

are sure of getting back the greater portion of what they lend. This may seem to be an overstatement, but it is not. Consider the present demand for land. The price of all kinds of lands has gone up. Many people who have made money in business want to invest their money in land, if possible. They offer very high prices for any land that may be offered for sale. These people know very well that the value of all kinds of land will fall after the war. But they are sure of getting back at least some of the money they have invested, and they are satisfied. This applied to people who are prepared to lend money for long periods. There may be some chance of the debts being scaled down at some time in the future, but this will not deter them from lending on long term, for they are sure of getting back at least a part of the principal.

5

Changes in money incomes, as distinct from changes in prices, give rise to a somewhat similar problem. But this problem is not the same as that discussed in the previous section. Suppose the incomes of all debtors fall, the level of prices remaining the same. If the debts owed by them are long-term debts, and

have been contracted before the fall in their incomes occurs, they will find themselves in a very difficult position when the debts fall due. They will have great difficulty in repaying the debts. Here a different question of justice as between creditors and debtors arises. Since there has been no fall in the level of prices, the debtors are not paying back to the creditors more than what they received from them at the time of borrowing. But still the fall in incomes will cause great hardship to them. The debtors, however, will not feel the effects of the fall in their incomes so much if the fall is gradual and if they have arranged to repay their debts by instalments. Suppose there is an abrupt fall in the incomes of all persons who have contracted long-term debts. Then a very difficult problem will arise. But are we justified in assuming that the incomes of all persons who have contracted long-term debts can rise or fall together? They need not necessarily move together. The debtors may belong to different classes. Is the problem referred to at the beginning of this section likely to arise at any time? Is it not an imaginary one?

So far as India is concerned the problem is a real one. Here, at any rate, the majority of debtors belong to the agricultural class, the

most numerous class in India. No less than 70 per cent of the agriculturists are in debt.¹ It is a well-known fact that more than 70 per cent of the people in this country are engaged in agriculture. This means that more than 50 per cent of the debtors in this country belong to the agricultural class. In the case of long-term debts, the vast majority of the debtors are agriculturists. This must be obvious to the most casual observer. In India people engaged in industrial pursuits very rarely go in for long-term loans. As we shall see later,² there are very few agencies for supplying long-term credit to people engaged in production. Moreover, it is only people who have some immovable property that can obtain long-term loans. It is quite clear that people who contract long-term debts are generally agriculturists. Now is there any danger of their incomes falling when the level of prices remains constant? It appears that the prices of agricultural commodities had been falling since 1926. Even if there had been no crisis in 1929, India would have suffered from an agricultural depression which would have been at its worst in 1930, or 1931.³ When there is

1. "Economic Problems of Modern India," ed. Radhakamal Mukerjee, Vol. I, (1939), p. 328

2. See below, Chap. VI, Sect. 4.

3. "Economic Problems of Modern India," ed. Radhakamal Mukerjee, Vol. I, (1939), p. 328.

an agricultural depression, the incomes of the majority of those who have contracted long-term debts will fall. The majority of them are landowners (it is mostly landowners who borrow long-term loans), and landowners get less money for their produce.

There will be a serious problem if there is a great and abrupt fall in agricultural incomes. In this case, debts cannot be compulsorily scaled down. That would be unfair to the creditors, for there has been no fall in the general price level. We must find a different solution for this problem. Debt conciliation is the only solution. Government must set up a special machinery for the conciliation of rural debts contracted before the fall in agricultural incomes.

Sometimes the two problems discussed above arise simultaneously. This may be illustrated by what happened in India in the course of the Great Depression. As every student of Economics knows, the last world slump in prices began with a tremendous crash in the New York Stock Exchange. After this there was a swift recession in prices which spread throughout the world. In India too there was a catastrophic fall in prices. The index number stood at 203 in 1929. It was

127 in 1931.¹ It is a well-known fact that during this economic depression the fall in agricultural prices was in many cases greater than the fall in prices of other commodities. The incomes of most classes in India fell, but the fall in agricultural incomes was greater than the fall in other incomes. In Bengal, for instance, the percentage fall in agricultural incomes between 1928-29 and 1932-33 was 61.2.² Those agriculturists who had contracted long-term debts before the fall in prices were doubly hit. Since prices had fallen, they had to pay their creditors more than what they had borrowed. At the same time their *real* incomes had fallen. Most of them were faced with a crisis. The defects of money as a standard of deferred payments were clearly seen for the first time in this country. In a case like this, the agricultural debts must first be compulsorily scaled down. The reduction should be in proportion to the fall in the general level of prices. Since the fall in agricultural prices is greater than the fall in other prices, the agricultural debtors must

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1. See Index Number of Indian Prices, 1861-1931. This is a Government publication showing the general course of prices in India since 1861 with 1873 as base year.
 2. "Economic Problems of Modern India," ed. Radhakamal Mukerjee, Vol. I, (1939) Chap. XV, p. 339. Chapter XV deals with the last economic depression.

get further relief; they will not be able to pay even the scaled-down debts. But this time recourse must be had to what is called debt conciliation. This is the only procedure that can be adopted. In no case should the principal be compulsorily reduced by an amount which is not justified by the fall in the general level of prices. As everybody knows, attempts were made to reduce the burden of rural indebtedness; but not in the way suggested above; nor was any attempt made to check the fall in agricultural incomes. It was but natural that money incomes should fall in India after the economic depression set in. But the fall in agricultural incomes was in many cases greater than the fall in other incomes. Agriculturists find themselves in a peculiar position whenever prices and incomes fall. Manufacturers often try to arrest a fall in prices by cutting down production. But agriculturists cannot adjust the supply of agricultural produce to the demand so easily. Nor is it desirable that they should restrict the supply of agricultural produce the moment agricultural prices fall. Indian agriculturists were clearly at a disadvantage during the last economic depression. It would not have mattered much

if they had not been heavily indebted. But many of them had contracted debts before the depression. They could not repay even the scaled down debts because of the fall in their real incomes. These ought to have been reduced still further by means of conciliation.

CHAPTER V

THE SOURCES OF LONG-TERM CREDIT.

1

The supply of long-term credit is a much more complicated problem than the supply of short-term credit. It is not more complicated because of the existence of the problems discussed in the previous chapter. I am not referring to these problems. The supply of long-term credit implies two different problems. In the first place, an adequate supply of long-term credit on reasonable terms has to be provided. But this is not the only thing. We have to see from what particular sources long-term loans are to be obtained. In the case of short-term credit, people do not greatly bother about the sources from which such credit is obtained. A man who obtains a short-term loan does not care from what source he has obtained it. The fact of his

getting it is more important than any other fact. But that is not so in the case of the borrower of a long-term loan. His main problem is to secure a long-term loan at a reasonable rate of interest. But that is not his only problem. The success of a long-term loan depends on several things, and some of these things depend on the source from which the long-term loan is obtained. As we have already seen, one of the factors governing the utility of a long-term loan is the period of the loan.¹ In every case the period of the loan must be sufficiently long. Now, whether the money can be borrowed for a long period or not depends on the sources from which it is borrowed. Long-term credit can be obtained from individuals as well as credit institutions. As a rule individuals will not lend money for very long periods. Some institutions lend money for longer periods than some other institutions. Take the question of repayment. The success of a long-term loan depends mainly on the manner of repayment. It is in most cases absolutely necessary that the loan should be repaid by instalments. A debtor who tries to pay every year a part of the debt will ultimately clear himself of debt.

1. See above, Chap. I. Section 3.

But a debtor who hopes to repay the debt in a lump at the end often fails to repay it. This is not the only advantage of repayment by instalments. One way of overcoming the defects of money as a standard of deferred payments is to repay all long-term loans by instalments.¹ Moreover, when a long-term loan is borrowed solely on the security of a life policy, it has to be repaid by instalments.² But long-term loans cannot be repaid by instalments when they are borrowed from certain sources. A private individual who lends a sum of money for a long period expects to receive it in a lump at the end of the period. Then again, the yearly instalments to be paid by the borrowers of long-term loans can be collected more regularly and with greater ease if the loans are obtained from some particular sources.³ All these things have to be taken into account while considering the suitability of a particular source of long-term credit. We must, therefore, make a very careful survey of the sources of long-term credit and see what particular sources can be utilized.

There are three main sources of long-term credit. Long-term credit can be obtained from

1. See above, Chap. IV, Sect. 4.

2. See above, Chap. IV, Sect. 1.

3. See below, Chap. VII, Sect. 1.

private individuals who are prepared to invest their savings at long term. It can be obtained from credit institutions like land-mortgage banks. Under certain circumstances the Government itself may supply long-term credit. In this and the following two chapters we shall consider these three main sources of long-term credit. In this chapter we shall consider the system of long-term credit under which private individuals provide long-term credit, as well as certain indigenous credit institutions which provide long-term loans.

2

We shall begin with the most common source of long-term credit in India. Most agriculturists who are in need of long-term credit do not rely on credit institutions to provide them with such credit. They approach individuals who have saved some money and who are prepared to lend it for long periods on the security of immovable property. Even in those parts of India where land-mortgage banks exist, "the loans advanced by the land mortgage banks form an insignificant part of the rural debt and have not touched even the fringe of the problem."¹ In fact, most people

1. Sir Manilal B. Nanavati and Prof. J. J. Anjaria, "The Indian Rural Problem," (2nd Ed.), p. 199.

who go in for long-term loans obtain such loans from private individuals. This is the most common system of long-term loans in this country.¹ It is also the simplest and, in some respects, the cheapest, system. This system has been condemned by many economists, publicists and social workers. Many regard it as unsound. It is unsound in many ways; it has many drawbacks. But it has also many advantages, and the advantages far outweigh the disadvantages. Moreover, it is quite possible to improve the system, although it can never be perfected.

One of the greatest advantages of this system is its simplicity. It is peculiarly adapted to the instincts of the villagers. A villager who is in need of long-term credit will not ordinarily approach a land-mortgage bank. There is a long and complicated procedure to be gone through. Statements have to be filed; all sorts of records have to be produced. There are usually long delays. That is why agriculturists who need long-term loans prefer to get them from individuals who are prepared to lend money on long term. The procedure involved, as everybody knows, is extremely simple. If the lender knows the borrower

1. See Appendix II.

very well, he may not even require the borrower to produce what is known as an encumbrance certificate.¹ Thus much delay and expense can be avoided.

Another advantage of the system is this. It is much easier for a landowner to get a long-term loan under this system than under any other system. Credit institutions which provide long-term credit are most particular about security. Of course, they cannot, and should not, lend on insufficient security. But the rules regarding security are very often too rigid. Even Governments which provide long-term credit for agriculturists appear to be too particular about security. The Madras Government lends long-term loans to agriculturists in special cases. But under the rules no loan shall be granted unless the value of the security offered exceeds by at least one and a half times the amount of the loan.² If an agriculturist wants a loan of Rs. 2000/- he must offer as security immovable property worth at least Rs. 5000/-. The value of the security should *exceed* the amount of the loan by one and a half times. Unfortunately, in

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1. A certificate from the Registry Office showing that the estate to be mortgaged by the borrower is unencumbered.
 2. See Rule VIII(1) of the Rules for the grant of loans for the relief of indebtedness under the Agriculturists' Loans Act, 1884, as amended by the Madras Act XVI of 1935.

the Madras Presidency many of the landowners are heavily indebted; in many cases the value of the property owned by the debtor may not exceed by one and a half times the amount due to the creditor. This means that these agriculturists cannot take advantage of the facilities offered by the Government. But a private individual who is prepared to lend money for a long period may not be so strict in regard to this matter. This is the experience of many borrowers who have borrowed long-term loans on the security of their immovable property. If the borrower needs a long-term loan of Rs. 2000/- he may have to offer as security immovable property worth Rs. 3000/- or Rs. 4000/- at the most. This cannot be regarded as insufficient security. A debtor who owns immovable property worth Rs. 3000/- and owes Rs. 2000/- to his creditor or creditors cannot be regarded as insolvent. He must be given an opportunity to rehabilitate himself. If he is a non-agriculturist he may pay the debt by selling his property. But an agriculturist cannot do so; he is rooted to the soil, and for him the loss of his property may be a serious thing. Such a man must be given an opportunity to keep his property. He can clear himself of debt only if he obtains a long-term loan on easy terms.

The system referred to above has yet another advantage. Under the system, a borrower of good standing can secure a long-term loan at a comparatively low rate of interest. If the borrower can offer good security and if in addition he is personally known to the lender, the lender will be prepared to accept a rate of interest which is somewhat lower than the rate of interest charged by institutions providing long-term credit. It is not to be understood that this system is always cheaper than the other systems. It may be on the whole uneconomic. But there is no doubt that from the point of view of certain individual borrowers it may be cheaper than other systems. A land-mortgage bank will not discriminate between one borrower and another borrower; it will charge a uniform rate of interest. Even a borrower whose credit is high and who can offer very good security has to pay the same rate of interest. But he can get a long-term loan at a lower rate of interest if he approaches a private person who is prepared to lend money for long periods.

But the system is not free from defects. It is quite obvious that, under this system, repayment of a long-term loan by instalments is almost impossible. An individual who

invests his money at long term does not like the idea of repayment by instalments. What is he to do with the money which he receives from the borrower every year during the currency of the loan? He will find it difficult to reinvest it. It is very rarely that a long-term loan borrowed from an individual is repaid by instalments. There are cases where money lent by individuals on the security of immovable property has been recovered by instalments. Instalment mortgage-bonds are not unknown under this system.¹ But these are exceptional cases. We cannot blame the creditor if he does not consent to the repayment of the principal by instalments. This defect is inherent in the system. It is only in the case of a long-term loan borrowed from a credit institution that repayment by instalments is possible.

This system of credit has one or two other disadvantages. Under this system it is not possible for any borrower to obtain a loan for a very long period. A long-term loan must ordinarily run for twenty years or more. But most private individuals are not willing to lend money for more than ten or twelve years

1. I know of two mortgage deeds which provide for the repayment of the principal by instalments. In both the cases, a long-term loan had been borrowed from a private individual.

at a time. This applies even to those who are willing to invest their savings at long term. I know that a long-term loan made for a period of ten years or twelve years is often renewed, if the borrower is not in a position to repay the loan at the end of the period. In fact, there is no need to renew it in such cases. The period of limitation which governs a suit to recover the money due on a mortgage is 12 years.¹ So the creditor can wait for nearly 12 years after the loan becomes due. In many cases the creditor has waited for a number of years after the loan fell due. It is very rarely that the creditor rushes to court as soon as the loan falls due. In practice the borrower obtains a loan for more than 12 years.² But his position becomes somewhat precarious after the loan becomes due. He will be at the mercy of his creditor. He is uneasy, with the sword of Damocles hanging over his head. It is, however, useless to expect a private individual to lend his money for more than 10 or 12 years. No individual likes to lend money to another individual for more than 12 years in the first instance.

1. See Articles 132 of the First Schedule to the Indian Limitation Act of 1908.

2. I know of four cases in which a mortgage loan of this kind was recovered after a period of more than 20 years.

The case of usufructuary mortgages is quite different.¹

This system of credit has certain disadvantages which are not so obvious as those mentioned above. The success of a long-term loan generally depends on the attitude of the lender. He should not be actuated by any sinister motives in making long-term advances on the security of immovable property. His sole object should be to invest his savings at long term. But a man who advances money to another on the security of land has often other objects. He secretly hopes that when the loan falls due the borrower will not be able to repay the loan. The mortgage gives him a claim on the land which is offered as security, and the lender hopes to get it at a low price at a court auction. A man who lends money on the security of land sometimes takes a sinister interest in the estate which is mortgaged to him. He looks forward to the day when the estate will be his. His attitude is not unlike that of Quomodo, the usurer, in Middleton's comedy, "Michaelmas Term". In the play Quomodo does not succeed in getting the estate which has been pledged to him by the borrower; in the end he loses his money as well as his wife. But his modern counterpart

1. See below, Sect. 3.

is usually more successful. Many an estate which is mortgaged ultimately passes to the lender. All this because the lender is actuated by sinister motives. He will allow interest to accumulate; he will claim his money just at a time when the borrower is unable to meet his obligations.

One other defect of the system may be noticed. Although at the present time most agriculturists who are in need of long-term credit borrow from private individuals who are prepared to lend on long term, this source of long-term credit is not fully utilized under present conditions. A certain agriculturist in a village may badly need a long-term loan; in a neighbouring village there may be a person who wants to invest his money at long term and may be willing to lend it on the security of land; but the man who wants to borrow may not come to know of the fact that in the neighbouring village there is one who is willing to lend. People who want long-term loans and can offer good security cannot get into touch with people who want to lend their money for long periods on the security of land. There is no proper organization. But this defect is not inherent in this system of long-term credit. As we shall see, it can be overcome.

The system, then, has many disadvantages. Is it worth while to preserve it? Opinion on this subject is divided. The system has been severely condemned by many persons who are interested in rural development. The system is usually associated with the village money-lender; and there is so much prejudice against the money-lender. Many writers on agricultural credit see nothing good in the village money-lender; they do not mention him except to curse him. But it is a mistake to associate this system with the village money-lender. The typical village money-lender very rarely lends money for long periods on the security of land or other immovable property; he lends small sums to ordinary cultivators. Agriculturists who need long-term credit usually borrow from persons who are not professional money-lenders. The lenders in this case are persons who have saved some money and want to invest it at long term. They include all ranks of society. Business men who have retired from business after earning some money, agriculturists who have saved a little money, widows who have been left some money by their deceased husbands,—all these may be willing to lend at long term. It is true that some of them are greedy and

unscrupulous; it is true that some of them cast covetous eyes on the estates which have been mortgaged to them by persons who have borrowed long-term loans from them. But they are not more dishonest than other people. Nor are they so dishonest as the typical village money-lender. It should be noted that even if they are dishonest, they have no opportunity of defrauding the borrowers. People who go in for long-term loans are usually respectable agriculturists and the transactions in all these cases are open. At the worst, the lender may not co-operate with the borrower in making the long-term loan a success. If the borrower is careful, no harm will result. The prejudice entertained by some persons towards this system is not justified.

It must not be supposed that this system of long-term credit is the best we can think of. The system, as we have seen, has grave defects. But there is not the least doubt that the advantages outweigh the disadvantages. It is, therefore, worth while to preserve this system. Just now, of course, we cannot dispense with the system; just now people who are in need of long-term loans take such loans mostly from private individuals. But private individuals will continue to provide

long-term loans even under a highly developed system of long-term credit. The chief merit of the system with which we have been dealing is its simplicity; it is a system which is suited to the temperament and genius of the people living in rural areas. As we have seen, under this system a borrower of good standing can utilize his individual credit more effectively; he can get a long-term loan from a private individual who knows him at an exceptionally low rate of interest.

But we should not overlook the defects. Fortunately, some of the defects can be removed. Although repayment of a long-term loan by instalments is almost impossible under this system, the borrower can make some provision for amortizing the principal of the loan. He will, if he is wise, start a sort of amortization fund and pay into this a certain sum of money every year. The money should be deposited in a land-mortgage bank which will be glad to receive money on fixed deposit. The man will be able to get a fairly high rate of interest. When he has saved enough money he can repay the principal. Interest, of course, must be regularly paid. If these precautions are taken, the long-term loan will be a success, although there is no provision

for repayment by instalments. These things may be possible in future, when people will be better educated and when there will be a network of land-mortgage banks in the country.

As already said, one grave defect of this system is lack of organization. People who want long-term loans are not in touch with those who are prepared to lend money for long periods on the security of immovable property. This defect can be remedied to a certain extent. This is a matter for the landholders' associations in the country. As we know, long-term loans can be usually borrowed by those who own land. The difficulty noticed above will disappear if there is a network of landholders' associations in the country. People who want long-term loans can get into touch with those who are willing to lend at long term, through these associations. Every landholders' association will maintain a register of landholders who are in need of long-term credit. The association can find out which of the members are in need of long-term credit by circularizing the members. A member who is in need of a long-term loan should furnish his association with the following particulars: the amount of money which he wishes to borrow and the period for

which he wishes to borrow, particulars of his immovable property and details of any mortgage, lien or charge subsisting thereon; the amount and particulars of claims against him, together with the names and addresses of his creditors. Similarly, a man who wishes to lend money for long periods on the security of land can register himself with the local landowners' association. The amount of money which he is prepared to lend on the security of land, the period for which he is prepared to lend his money and the rate of interest which he expects must be made known to the association. Thus a landowner who is in need of long-term credit can get into touch with the person who is best able to provide his needs.

3

We may now consider a system of long-term credit which is not essentially different from the one considered above, but which raises different problems and will be found suitable only in a few cases. I am referring to usufructuary mortgages. Under this system, the man who lends a long-term loan enjoys possession of a piece of land under usufructuary mortgage during the currency

of the loan. He does not receive interest from the borrower; but he holds possession of the land and cultivates it, paying land revenue. At the end of the period stipulated in the mortgage deed, the mortgagor will get back his land on paying the principal. Usufructuary mortgages are not now so common as they were before. Formerly an agriculturist who wanted a long-term loan would almost always get it from another agriculturist in his own village or a neighbouring village. At that time the only monied class was the agricultural class. An agriculturist money-lender may not always dislike the idea of a usufructuary mortgage. Hence usufructuary mortgages were fairly common until the beginning of the twentieth century. But nowadays persons other than agriculturists are in a position to make long-term advances on the security of agricultural land. These persons do not like usufructuary mortgages; they do not like the idea of holding possession of a piece of land and cultivating it. They want to receive every year a fixed sum of money by way of interest, without any trouble whatever. Naturally usufructuary mortgages are not very common at the present time.

But is it worth while to extend this system? The system has undoubtedly certain

advantages. The mortgagor need not bother about interest, and interest can never accumulate. This is an advantage from the point of view of the lender also. Of course, the lender will not get a fixed rate of interest; he will lose if the price of agricultural produce falls, or if there is a failure of crops. But this applies to the borrower also; he will lose if the price of agricultural produce goes up. Again, the repayment of the principal will not be a difficult problem; if the mortgagor is not in a position to repay the principal he need not worry; the mortgagee will continue to enjoy possession of the mortgaged property. The lender does not file a suit against the borrower when the period stipulated in the mortgage expires, but he will not relinquish the mortgaged property until he gets back his money. So there is no danger of litigation.

But the system has certain disadvantages. The mortgaged property may be redeemed by the borrower at any time after the expiry of the period mentioned in the mortgage bond. It is not usually redeemed if the value of land falls; but it is almost certain to be redeemed if the value of land rises. This is an advantage from the point of view of the mortgagor, but a disadvantage from the point of view of the

mortgagee. But in normal circumstances the mortgaged property is never redeemed. In the villages, in the majority of cases, a man who has borrowed a long-term loan is not likely to repay it unless and until he is forced to repay it. In the case of usufructuary mortgages there is no compulsion; he may redeem the estate at his option, and he is not eager to redeem it. The very purpose with which the long-term loan was borrowed is defeated.

But these are not the only disadvantages. The man who holds a piece of land under usufructuary mortgage is in a peculiar position. Although he is likely to hold the land for an indefinite period, he cannot make any improvements, even if he wants to. He will not get any compensation for the improvements made by him.¹ It is only in certain cases that he will get compensation. Where any improvement was necessary to preserve the property from destruction or deterioration or was necessary to prevent the security from becoming insufficient, the mortgagor shall, in the absence of a contract to the contrary, be liable to pay the proper cost thereof as an

1. See Section 63 A(1) of the Transfer of Property Act of 1882 as amended by Act XX of 1929 and Act V of 1930.

addition to the principal.¹ In all other cases the mortgagor shall not be liable to pay the cost of the improvement, unless, of course, there is a contract to the contrary. This is a serious disadvantage.

But the system of usufructuary mortgages should not be given up. In certain cases of indebtedness the proper remedy may be a usufructuary mortgage. Some landowners burdened with ancestral debts sometimes leave their native villages and seek work in towns and cities. They wish to return to their villages after they have earned some money; they hope to pay off their debts when they have earned enough money. But they will be in debt and their lands will be mortgaged for a pretty long period. In all such cases a usufructuary mortgage is to be preferred to a simple mortgage, because in the case of a usufructuary mortgage, the debtor will be saved the trouble of collecting the rent and paying interest. The danger of absentee landlordism also can be avoided; the man who holds the land under a usufructuary mortgage is sure to be an agriculturist of the place, for non-agriculturists living in distant places do not usually consent to a usufructuary mortgage. So in all these cases usufructuary mortgages are preferable.

1. See Section 63 A (2) of the Transfer of Property Act of 1882 as amended by Act XX of 1929 and Act V of 1930.

An attempt should be made to improve the system, which at present is far from perfect. Fortunately the defects noted above can be overcome. It should be quite possible to make provision for automatic redemption within a fixed period. If the piece of land which is mortgaged is sufficiently large and productive, the mortgagee can every year recover out of the income from the land interest on the principal as well as a part of the principal. In such a case the land can be redeemed at the end of the stipulated period. This is one of the innumerable recommendations made by the Royal Commission on Agriculture in India. The Commission were of the opinion that no usufructuary mortgage of agricultural land should be permitted by law unless provision is made for automatic redemption within a fixed period of years, of which twenty should be the maximum.¹ As regards improvements, there may be some trouble. But it is possible to make provision for improvements to the land mortgaged. The maximum amount which the mortgagee can receive from the mortgagor as compensation for improvements can be fixed in advance and clearly stated in

1. Abridged Report of the Royal Commission on Indian Agriculture, para. 47.

the mortgage deed. Of course, before fixing the amount the parties must see what improvements will be necessary. Such an arrangement will satisfy both the parties.¹

4

So far we have been dealing with those systems of long-term credit under which the loans are supplied by private individuals. In this and the following sections we shall consider certain institutions which provide long-term credit. The institutions which will be noticed in this section are indigenous institutions which differ from credit institutions registered under the Indian Companies Act.

The Nidhis and Funds of South India may be considered first. There is practically very little difference between Nidhis and Funds.² These institutions do not exist solely for the purpose of providing long-term

1. There is an arrangement of this kind in the case of a recent usufructuary mortgage in Mangalore. A certain portion of the immovable property which belongs to two minors has been mortgaged as security for a loan of Rs. 12500/-. It is a mortgage with possession of the property mortgaged. The period of the loan is 25 years. The land can be redeemed at any time after the expiry of the period; the mortgagor will get back the property on paying Rs. 12500/-. In the meanwhile the mortgagee can make any improvements that may be necessary; but he cannot claim more than Rs. 5000/- as compensation for improvements.
2. These Funds are distinct from Chit Funds, to be described in the next section.

credit; they lend money on the security of jewels for short periods. Nor are they very common in India; they are to be found only in South India. There were 228 Nidhis in the Madras Presidency in 1929.¹ They are particularly numerous in Coimbatore; in 1929 more than half the Nidhis in the Madras Presidency were in Coimbatore.² But they are mostly in towns. In Coimbatore District, however, many Nidhis lend long-term loans in the villages.³

The share-capital of the Nidhis is paid by monthly instalments spread over a certain period. The paid-up capital is withdrawable at the end of the period, when the Nidhi ceases to exist. The members of the Nidhi are entitled to borrow against their share-capital. The original idea was to help the members to get loans at low rates of interest. Even today the orthodox type of Nidhi has the same borrowing and lending rates.⁴ But the organization of these credit institutions is varied. Originally the funds were raised chiefly by subscription to "Share Capital". The receipt of deposits was not a primary object. But now many of them receive deposits

1. The Madras Banking Enquiry Committee Report, para. 438.

2. *Ibid*, para. 439.

3. *Ibid*, para. 152.

4. S. K. Muranjan, *op. cit.*, pp. 145-146.

freely. In some the monthly subscription to share-capital has been replaced by a recurring deposit. The terminating character of the Nidhi has in general disappeared.¹

As already said, these Nidhis and Funds lend long-term loans as a part of their business. The Madras Banking Enquiry Committee Report contains a brief account of the working of the Triplicane Fund Limited, in the city of Madras. It makes long-term advances on the security of buildings (usually dwellings) in Madras City. Most of its loans are for 12 years. Every year the borrower pays interest and also pays in fixed monthly instalments into an amortization fund and is allowed $6\frac{1}{2}$ per cent interest on this. The Fund also lends loans on the security of jewels.²

As credit institutions, Nidhis and Funds are far from perfect. They are also peculiar in many respects. Almost all of them provide both long-and short-term credit. The Madras Banking Enquiry Committee Report contains many suggestions for improving these institutions. Nidhis, it has been suggested, should encourage long-term recurring deposits and savings deposits, and should not lend on the

1. The Madras Banking Enquiry Committee Report, paras. 74, 75.

2. The Madras Banking Enquiry Committee Report, para. 50.

security of share-capital.¹ But before trying to improve these credit institutions, we must determine their place in our system of credit. And we must see whether it is worth while to develop these institutions.

In the Madras Presidency Nidhis seem to have been in existence for a long time; they existed before the co-operative movement was started in this country. Nidhis will probably survive, and deserve to survive. Originally, they were mutual loan societies. If properly conducted, they are much better than co-operative societies. Some of the so-called co-operative societies have to rely on outsiders for whatever capital they may require. But in the case of Nidhis the whole of the working capital can be raised by the members themselves. They are also much simpler. But I think their main purpose should be to provide long-term credit for their members. Short-term credit is best supplied by co-operative societies and other credit institutions. Nidhis and Funds should supply long-term credit in the towns and cities while land-mortgage banks should supply long-term credit in rural areas. Nidhis and Funds will make long-term advances on the security of buildings. They

1. Ibid, para. 462.

need not compete with house-building societies in the towns and cities. House-building societies exist for a slightly different purpose; they lend money on the security of house-sites and encourage the building of new houses.¹ But Nidhis will lend long-term loans for other purposes and will lend such loans on the security of buildings already constructed. Each member of a Nidhi or Fund should subscribe a fixed sum every month. Members who want long-term loans can obtain such loans out of the funds raised in this way.

The method of repayment adopted by the Triplicane Fund in Madras seems to be most suitable. This is as good as repayment by instalments. Nidhis and Funds should supply mostly long-term credit. If, in any month, there is a surplus, the surplus can be lent for short periods on the security of jewels.

Two things are necessary if an institution of this kind is to thrive; the members must know one another, and they must receive fixed monthly incomes. It is obvious that institutions like Nidhis and Funds are not suitable for rural areas.

5

There is one more indigenous credit institution which provides long-term credit.

1. See below, Chap. VI, Sect. 3

In certain parts of the Madras Presidency Chit Funds or Kuries are a common source of long-term credit. Chit Funds and Kuries are very common in Travancore, Cochin, British Malabar, Tinnevely and South Kanara.¹ Chit Funds and Kuries are not conducted on exactly the same lines, but they belong to the same class of institutions. It is not, therefore, necessary to consider them separately. In this section only Chit Funds will be described.² What is said about Chit Funds applies to Kuries. There are what are called monthly Chits. These provide only short-term credit. Only annual Chits can provide long-term credit. We will be concerned only with annual Chits.

There are various types of Chit Funds. A bewildering variety of transactions are conducted under the auspices of Chit Funds; not all the Chit Funds are conducted on the same principles. The Madras Banking Enquiry Committee noted six principal types of Chit Funds.³ I shall describe only one of the most common type of Chit Funds.⁴ For want

1. The Madras Banking Enquiry Committee Report, para. 76.

2. For a description of a Kuri see Section 3 (1) of the Cochin Kuries Act, where a Kuri is briefly defined.

3. The Madras Banking Enquiry Committee Report, para. 482.

4. I have studied at first hand the working of Chit Funds. I have made detailed investigations regarding 8 Chit Funds in the district of South Kanara in the Madras Presidency. These were Chit Funds which had run their course. My account of Chit Funds is based on those investigations.

of a better term it may be called the auction Chit. A brief description of this type of Chit Fund will give some idea of the working of Chit Funds and Kuries. But I am speaking only of those Chit Funds which provide long-term credit.

A Chit Fund is usually started by a man in need of long-term credit. He enrolls a certain number of members, who are willing to subscribe to the Fund. The man who organizes a Chit Fund is called the Stake-holder or the president.¹ It is more convenient to call him the president. The others may be called subscribers to the Fund, or simply members. The amount of the fund and the number of subscribers must be fixed by the president. The life of a Chit Fund varies. It depends on the number of members. If there are fifteen members, it will run for fourteen years. Usually a Chit Fund runs for more than 10 years. One Chit Fund was to have run for 18 years.² The average duration was 13 years in the case of the 8 Chit Funds which I noted. As soon as the required number of members are enrolled, the fund is put up to auction.³

1. The promoter of a Kuri is referred to as the foreman in the Cochin Kuries Act. (See section 3 (7) of the Cochin Kuries Act.)

2. The All-India Reporter for 1936 (Madras Section), p. 985.

3. Sometimes it is put up to auction during the second year. During the first year the president gets the fund without discount.

The person who offers the highest discount gets the fund. This will be distributed among the members. The president will levy contributions from the members. The successful bidder gets the fund less the discount and less the current contribution due from him. He binds himself to pay the future instalments by a bond. Every year he has to pay the contributions due from him. Every year the fund is similarly put up to auction. The successful bidder at any auction cannot bid at subsequent auctions; he thus drops out. But he has to pay the necessary contribution every year. He does not pay a fixed sum every year. The successful bidders at the earlier auctions in effect get a long-term loan which is to be repaid by yearly instalments.¹ Legally, I believe, the successful bidder at an auction is not in the position of a borrower. The successful bidder is in the same position as an auction purchaser. In the case *P. N. Raghavan and others vs. S. Arumugham and another*, the Madras High Court held that the contract is one of sale and not of borrowing.² But a Chit Fund is really a credit institution which provides credit, including long-term credit, to its members.

1. See Appendix III.

2. The All-India Reporter for 1936, Madras Section, p. 386.

This interesting and ingenious credit institution has certain merits. In some cases, the only way to raise a long-term loan is to start a Chit Fund. No single man in any locality may be in a position to lend a large sum of money for a long period. But a long-term loan can be easily provided if a certain number of persons join together and start a Chit Fund. A Chit Fund is a sort of co-operative undertaking. The successful bidders at the first few auctions get long-term loans which are repaid by instalments.¹ (In the case of a long-term loan, repayment by instalments is a very great advantage.)² The rate of interest is not unduly high.³ In most cases it is much lower than the rate charged by a professional money-lender. It is obvious that all the subscribers to a Chit Fund cannot obtain long-term loans. The bidder at the last auction obtains a loan for one year only, and the man who gets the fund at the end does not get any loan at all. But it must be remembered that all the subscribers are not in need of credit. A man who is able to save

1. They repay the loan by contributing to the Fund every year.

2. See above, Chap. I, Sect. 3.

3. Interest is not directly paid, but the successful bidder who receives the fund has to pay back, by way of annual contributions, more than what he has received. Moreover, he does not receive interest on the instalments paid by him.

some money every year, often finds that the best way of investing his savings is to subscribe to a Chit Fund. Thus some subscribers to a Chit Fund are in the position of lenders. A Chit Fund is twice blessed; it blesses him that lends, and him that borrows. The educative value of Chit Funds should not be overlooked. The promoter receives the greatest benefit; he also receives some training in business of a particular kind.¹ If properly conducted a Chit Fund inculcates thrift and the spirit of co-operation.

But this peculiar institution has many grave defects. Many malpractices have come to light. These are described in detail in the Madras Banking Enquiry Committee Report.² But I shall deal only with those defects which I have been able to discover.

A Chit Fund is a sort of co-operative undertaking, but the co-operative spirit is often lacking. If a Chit Fund is to be successfully conducted, all the members must live in the same place and must know one another. But this is very rarely the case. The members of a Chit Fund live in different

1. A successful banker whom I know began by organizing Chit Funds in his own place.

2. The Madras Banking Enquiry Committee Report, paras. 486, 487, 488, 489 and 490.

places and include all ranks of society. Instead of co-operation, there is competition. This is seen at the time of the annual auction. Competition among the subscribers is so keen that the man who needs a long-term loan most has to offer a very large discount; otherwise he will not get the fund. If the other subscribers come to know that he is badly in need of a loan, they will purposely bid for low amounts. They obviously gain if he offers a large discount; the larger the discount offered by the successful bidder, the smaller the contribution to be paid by each of the other members. There is often difficulty about security. The successful bidder, before receiving the bid amount, must execute a mortgage bond to secure payment of future instalments. The stake-holder or the president may not be satisfied with the security, although it may be quite sufficient. Then there will be a hitch. This results in much hardship for the member concerned, who is entitled to get the fund.

Collecting the contributions due from the members is often a hard task. The president is bound to pay the successful bidder at an auction the bid amount within a certain period. Very few members are prompt in paying their contributions. The president is partly to

blame; in his anxiety to start a Chit Fund he admits all sorts of persons. He is worried out of his wits in trying to find the money. The successful bidder too suffers; his plans are upset because he does not receive the expected amount in time. This often leads to litigation. Often enough the president himself is the cause of much trouble. Prof. S. K. Muranjan, who does not think highly of Chit Funds, says that the promoter is very often a needy man of straw.¹ He is not a man of straw, for a man of straw cannot get enough men to start a Chit Fund, but he is generally a needy man.² The president very often misappropriates the money which he receives from the members by way of subscriptions to the fund. Of course, he hopes that when the time comes he will be able to pay the successful bidder the bid amount. But usually he defaults, and creates trouble for himself and others. He saves himself by executing a promissory note in favour of the member to whom the money is due- a dubious way of saving himself.

If the president dies before the Chit Fund has run its course, there is great trouble. His place will be taken by his heir, or by one of

1. Prof. S. K. Muranjan, *op. cit.*, p. 146.

2. The Madras Banking Enquiry Committee Report, para. 79.

his heirs if he has more than one heir. But the successor may not take much interest in the Chit Fund; he cannot be expected to be as enthusiastic as the man who started the Fund. Moreover, he is not interested, as his predecessor had already received the Fund.¹

These are not the only difficulties. A member of a Chit Fund sometimes backs out after bidding unsuccessfully at one or two auctions. In that case the president has to find a substitute for him. This is not an easy thing. Thus the President has to contend with innumerable difficulties, and he often lands himself in a mess.²

But the defects noted above are not irremediable; the system can be improved to a great extent. The procedure adopted at the annual auction is highly objectionable. The member who is most anxious to get a fund is the one most in need of credit. If there is

1. The president of the Chit Fund receives the fund during the first or second year.

2. Of the 8 Chit Funds noted by me only one was working smoothly to the end. In three cases the president had utilized the money collected on behalf of the successful bidder for purposes unconnected with the Chit Fund and had great difficulty in paying the bid amount to the successful bidder. In one case the president refused to pay the successful bidder the bid amount on the ground that the security offered was not sufficient. In four cases there was trouble because a particular member refused to continue as a subscriber. In all the four cases the member who refused to continue as a subscriber was the one who had failed to get the fund at the previous auction. In most cases there was great difficulty in collecting the subscriptions.

real co-operation among the members, the man who is most in need of credit must not be compelled to offer an unusually large discount. At the time of the auction his talk and his behaviour betray his anxiety to get the fund. The others, as already noted, take unfair advantage of his position. But what is the alternative? The Prize Chit is a worse type of Chit. In the Prize Chit, a fixed sum or prize is drawn by lot. The member who draws the prize need not be the man most in need of credit. As Prof. Muranjan says, this type of Chit is not a credit institution at all, but a mere lottery.¹ I think the best thing would be to invite tenders from all those members who are entitled to bid. Each bidder should state in the tender the minimum amount which he expects. The president should receive sealed tenders which he should open in the presence of all the bidders. The man who bids for the lowest amount or, which is the same thing, offers the highest discount, will get the fund. In this case, a bidder does not know how much discount the others are prepared to offer, or how eager they are to get the fund. So far as I know, this system is rarely adopted.² But this system may not be

1. S. K. Muranjan, *op. cit.*, p. 146.

2. I know of one organizer of a Chit Fund in South Kanara District who has adopted this system. He calls it the "Tender System". I got the idea from him.

liked by many members of Chit Funds. They enjoy the excitement which prevails at an auction and the way in which each bidder tries to outwit the other. But the system referred to above is well worth a trial.

Some of the other defects too can be remedied. The president should not be allowed to misappropriate any part of the money received from the members as subscription to the Chit Fund. All moneys received must be put in the Post Office Savings Bank. As soon as the whole of the bid amount is collected it should be paid to the successful bidder. Failure to do this should be a criminal offence. As we have seen, the death of the president before the Chit Fund has run its course leads to complications. None of his heirs may be in a position to carry on the work; even if any of his heirs is capable of conducting the Chit Fund, he may not take as much interest as he should. Whenever a president dies, the proper procedure would be to elect a new president.¹

The Government should have some control over the Chit Funds. The control should take the form of registration by the District

1. The successful bidders at previous auctions have no stake in the Chit Fund; so they are not eligible for the post of president. But they may be allowed to vote at the election.

Officer. This is one of the recommendations contained in the Madras Banking Enquiry Committee Report.¹ Government should also frame rules for the conduct of Chit Funds. For instance, there must be definite rules regarding the disposal of the money collected from the subscribers. The rules should provide for the election of a new president, in the event of the death of the president before the Chit Fund runs its course.

It is interesting to note that an act for controlling Chit Funds has been passed in Travancore.² A similar Act has been passed in Cochin State. These are the main provisions of the Cochin Kuris Act of 1107 as modified up to 1113.³ Every Kuri should be registered, and if not so registered it will be void.⁴ Every foreman should furnish sufficient security before starting the Chit Fund. Every foreman should, before the first drawing of the Kuri, execute a bond in favour of or in trust for the other subscribers charging by way of security property sufficient for the realisation of twice the Kuri amount.⁵ There are also provisions regarding the disposal of moneys received

1. The Madras Banking Enquiry Committee Report, para. 496.

2. The Madras Banking Enquiry Committee Report, para. 79.

3. 1107 and 1113 are the years of the Cochin official Era.

4. See Section 4 of the Cochin Kuris Act.

5. Section 13 (1) of the Cochin Kuris Act.

from members.¹ The Act requires every foreman of a Kuri to maintain certain registers. The registers are mentioned in the Act.²

But we should not have any illusions about these Chit Funds. As institutions providing long-term credit they have little value. As we have seen it is only one or two members who can hope to get a long-term loan. These are the successful bidders at the earlier auctions. And these members cannot expect to raise large funds in this way. So far I have noted only one Chit Fund of Rs. 5000/-. It is very rarely that a Chit Fund exceeds Rs. 2000/-. Chit Funds of Rs. 1000/- are much more common than Chit Funds of Rs. 2000/-. It is clear that the fund cannot be a large one; in the case of a big fund it is difficult to get enough subscribers in a limited area, and the area must be necessarily limited. If the subscribers to a Chit Fund are scattered all over the district, the Fund cannot work successfully. This is obvious. So a rich agriculturist who is deeply in debt cannot hope to save himself by subscribing to a Chit Fund. As we have already seen,³ in the case of every

1. Section 15 (2) of the Cochin Kuris Act.

2. Section 16 of the Cochin Kuris Act.

3. See above, Chap. I, Sect. 3.

long-term loan the amount borrowed should be enough to enable the borrower to pay off all his previous debts. But I have seen many rich agriculturists who are in need of large long-term loans subscribing to Chit Funds of Rs. 1000/- and Rs. 2000/-. This will not help them at all; on the contrary it will create more complications for them. Lastly, Chit Funds do not work successfully in most cases. As the Madras Banking Enquiry Committee Report says, they are too cumbrous for financing agriculture on a large scale.¹ But they are an interesting survival from the past, and may be allowed to survive. Chit Funds are the peculiar contribution of South India in the field of banking. In spite of their many defects they are popular in those districts of South India where they are common. A landowner who needs a long-term loan often finds that the best and easiest way of getting it is to start a Chit Fund.

CHAPTER VI

THE SOURCES OF LONG-TERM CREDIT-

(continued)

1

So far we have been dealing with the indigenous system of long-term credit. Under

1. The Madras Banking Enquiry Committee Report, para. 151.

this system long-term credit is for the most part supplied by private individuals. Institutions providing long-term credit are not unknown; there are, for instance, Nidhis and Chit Funds.¹ These are simple institutions and are of a co-operative character. We have now to consider the system of long-term credit which has been imported from the West. Under this system long-term credit is supplied by institutions which are in one sense banking organizations. There are various types of institutions providing long-term credit. Before examining these various types, it is necessary to study the nature and working of these institutions. These institutions are conducted on different principles. But we may discuss some basic principles which are common.

The working capital of these institutions may be derived from three sources. They may receive deposits; but the deposits must be always long-dated deposits. Otherwise they cannot make long-term advances out of deposits received by them. A large part of their working capital is derived from share-capital. All of them may issue what are called debentures; in fact they rely on a large debenture issue.

1. See above, Chap. V. Sects. 4 and 5.

The advantages of this system of long-term credit are fairly obvious. Institutions which derive their working capital from sources mentioned above are in a much better position to provide long-term credit than private individuals. A man who has saved a very small sum of money may be prepared to lend it on long term. But who will borrow a very small sum of money for a long period on the security of his immovable property? If, however, a few individuals who have saved very small sums of money deposit their money with an institution which provides long-term credit, a pretty large sum of money can be raised and lent at long term. Thus very small sums of money which would not ordinarily be lent at long term could be collected together and invested at long term. The same thing will happen if these individuals buy debentures issued by credit institutions providing long-term credit, instead of depositing their money with them. If the price of a debenture is Rs. 100/-, ten persons who have saved Rs. 100/- each can buy in all debentures to the value of Rs. 1000/-. In this case a sum of Rs. 1000/- can be lent for a long period to a man who is in need of long-term credit. Credit institutions can thus increase the supply of long-term

credit, although the total sum of money saved remains the same.¹

There are two difficulties in the way of providing long-term loans. In the first place, a man who is prepared to lend on long term may not have saved enough. In that case it may be utilized for some other purpose. But this difficulty does not exist under the system just referred to (i. e. the system under which credit institutions issue debentures). Another difficulty in the way of providing long-term credit is this; a man who has saved a large sum of money may not be prepared to lend for a long period. Ordinarily it will be lent for short periods. But even this money can be lent on long term; the man has only to invest his money in debentures issued by a credit institution providing long-term credit. True, he is not prepared to invest the money at long term; but he can have his money back whenever he wants it. Debentures issued by a reputable credit institution are readily marketable. A man who has bought such debentures can easily sell them whenever he wants cash. Such debentures may be constantly changing hands. But a large sum of money can be lent for a long period by this means. It is as if a number of persons lent a

1. See above, Chap. 1, Sect. 6.

large sum of money to one single individual for short periods in succession. There is no break anywhere, and the result is a long-term loan. I would compare the provision of long-term credit to the carrying of a heavy burden over a long distance. None of the men available may be able to carry the burden all the way. In that case a man can carry the burden over a part of the distance and pass it on to another man on the way. The latter will similarly pass it on to another man on the way. That man will similarly pass it on to some other man after carrying it for some distance. In this way the whole load can be carried over a long distance. Similarly, no single man may be able to lend a large sum of money for a long period. But a large sum of money can be raised if a number of persons who have saved small sums of money buy debentures issued by a credit institution dispensing long-term loans. These men who have bought the debentures may not be necessarily men who are prepared to invest their savings at long term. But they can sell the debentures to others after some time and the buyers of these debentures can similarly sell them to others. Thus the task of providing long-term loans is lightened in

two ways. No single man need lend large sums of money; and no single man need be prepared to lend on long term.

This is the easiest and most convenient way of raising long-term loans. Credit institutions which provide long-term credit should derive their working capital chiefly from debentures. They should make advances out of the money which is raised by selling debentures, rather than from long-dated deposits. The question of share-capital is not relevant to this issue. Although a part of the working capital is derived from share-capital, the shares issued by the institutions are not loans in any real sense. But people who hold debentures are really lenders; they in effect lend long-term loans through the credit institutions, and we are here concerned with the best way of raising long-term loans.

Credit institutions which exist for the purpose of providing long-term credit should issue debentures and should derive a large part of their working capital from such debentures. The system is not only inevitable; it is the best and most scientific system we can think of. So far as I know, this has not been sufficiently stressed. Authorities on this subject favour a large debenture issue; but

they have in mind the difficulty of attracting long-dated deposits. Even if it is possible to attract long-term deposits, credit institutions providing long-term loans should not rely on deposits; they should derive their working capital from debentures. The practical implications of this will be considered in Chapter VII, Section 1.

Finally, this system is more economical than the one described in Chapter V, Section 2, although the latter system is much more common at present. Whenever long-term loans are supplied by institutions like land-mortgage banks, the loans can, and will, be recovered by instalments. This will enable us to economize in the use of long-term credit. Suppose a land-mortgage bank lends a man Rs. 2000/- for 20 years. At the end of the first year the bank will recover from him interest on Rs. 2000/- plus Rs. 100/-, if the loan is to be repaid by annual instalments. The hundred rupees can be lent to some other person for 19 years. Hundred rupees is too small a sum to be lent as a long-term loan. But when, at the end of the first year, 20 borrowers who have each borrowed Rs. 2000/- for 20 years, pay the first annual instalment, a sum of Rs. 2000/- can be lent for a period of

19 years with the money which is paid by way of repayment. If there are hundred such borrowers, five fresh long-term loans can be provided at the end of the first year with the money which is paid by way of repayment. If the second batch of borrowers is very large, some fresh long-term loans can be lent for smaller periods at the end of the second year, when they repay a part of the money borrowed. Thus with the same resources we can provide a much larger number of persons with long-term loans.

2

It is necessary to consider the various classes of institutions providing long-term credit. It is not possible in the space available to describe in detail the various classes of banks and other institutions dispensing long-term loans. Moreover, a detailed description of these institutions is out of place in a work of this kind. I shall content myself with describing the principles on which these credit institutions are conducted.

We may begin with land-mortgage banks. These are banks run on Western lines. These banks lend to their customers on real estate mortgage, and they lend long-term loans. Let

us examine the working of a typical land-mortgage bank. The Udipi Co-operative Land-Mortgage Bank, which was started some years ago, is conducted on the following principles:

The share-capital of the bank consists of "A" class shares of Rs. 10/- each, and "B" class shares of Re. 1/- each (see By-Law 4 of the bank).

Under By-Law 7(a) every member shall buy at least one share.

The bank obtains funds from the following sources: (1) Share-capital. (2) Loans from the Central Land-Mortgage Bank in Madras. (3) Entrance and other fees (See By-Law 16). It is clear that the Bank does not receive deposits.

Under By-Law 37 loans shall be given only to members.

By-Law 42 says, "Every loan shall be secured by a mortgage of lands and shall not exceed 50 per cent of the estimated market value of the lands".

The maximum period for which a loan can be lent is 20 years. (See By-Law 46). Under By-Law 48-A, the loans are to be recovered by instalments.

There is the greatest need for land-mortgage banks in a predominantly agricultural

country like India. But we have not fully realised the need for such banks. For many years after the advent of European banking in this country there were no separate banks for providing long-term credit. In some cases long-term credit was supplied by ordinary banks.¹ In the Madras Presidency ordinary credit co-operative societies were not averse to lending money for long periods. Many of them were lending money for 10 years or more when the Madras Banking Enquiry Committee reported. A large portion of the funds belonging to co-operative societies had been lent for long periods on the security of land.² Even today the country does not have a sufficient number of land-mortgage banks. Land-mortgage banks were first started in the Punjab. Now they are fairly common in Bengal, the United Province, the Central Provinces, Orissa, Bombay, Madras and in Baroda, Mysore and Cochin among the Native States.³ But there are no land-mortgage banks in so many parts

1. See above, Chap. 1, Sect. 5.

2. See the Madras Banking Enquiry Committee Report, para. 352.

3. In an article contributed to the Indian Journal of Social Work Mr. V. L. Mehta, Managing Director of the Bombay Provincial Co-operative Bank, describes the progress achieved by some of the leading Provinces and States in India. See the Indian Journal of Social Work, Vol. III, No. 3, p. 350. See also Sir Manilal B. Nanavati and J. J. Anjaria, "The Indian Rural Problem", (2nd ed.), pp. 194-196.

of India. There must be a network of land-mortgage banks in the country if we are to make long-term credit readily available for capital agricultural improvements.

Land-mortgage banks are not conducted on the same principles as other banks. It is quite evident that a land-mortgage bank trading on ordinary deposits cannot provide long-term credit. If long-term loans are to be found, long-term deposits must also be found. But it may be difficult to attract long-term deposits. Moreover, even the so-called long-term deposits are not really long-term deposits. The money may be deposited for five years at the most. The money may not be withdrawn at the end of the period, but it is not deposited for more than five years in the first instance. As a matter of fact, land-mortgage banks do not receive deposits. Land-mortgage banks derive their capital from other sources. The need for issuing debentures has been fully discussed in the previous section. The Madras Banking Enquiry Committee stressed the need for a large debenture issue. The Committee believed that land-mortgage banks could not be a success without a large debenture issue.¹

It is, therefore, of the greatest importance to make such debentures readily negotiable

¹. The Madras Banking Enquiry Committee Report, para. 173.

and marketable. They will be readily marketable if the Government guarantee interest on the debentures. The rate may be fixed by the Government. The Madras Government has guaranteed the principal and interest on the debentures issued by the Central Land-Mortgage Bank.¹ Another way of making these debentures readily marketable is to vest the land-mortgage banks with summary powers of recovery of loans. They should be able to recover the loans without the intervention of a civil court. I find that land-mortgage banks in the Madras Presidency have such powers. Further, it should be possible to invest trust funds in debentures issued by land-mortgage banks.²

It is clear that the land-mortgage banks can never be self-sufficient. Some central organization seems to be necessary. There should be for every province a Central Land-Mortgage Bank. This should be distinct from the Provincial Co-operative Bank. The land-mortgage banks in the province can derive a part of their working capital from this Central

1. "Economic Problems of Modern India", ed. Radhakamal Mukerjee, Vol. I (1939), Chap. X, pp. 100-101. Chapter X deals with Co-operation and was contributed by the late Mr. V. Ramadas Pantulu.

2. This is made possible by a special amendment to Section 20 of the Indian Trust Act. At present debentures issued by Central Co-operative Land-Mortgage Banks are regarded as Trustees Securities.

Bank. Only the Central Land-Mortgage Bank should be authorised to issue debentures. The primary land-mortgage banks should not be allowed to compete with the Central Land-Mortgage Bank in this matter. The whole organization will be strengthened if the issue of debentures is centralized. These arrangements have been adopted in almost all the provinces where land-mortgage banks have been started.

Will the Central Land-Mortgage Bank be self-sufficient? Some leading co-operators and economists doubt whether it will be self-sufficient. They have recommended the establishment of an All-India Co-operative Bank which will provide long-term loans for these Central Land-Mortgage Banks in the country. Dr. P. S. Lokanathan, for instance, has recommended the establishment of such a Bank. He believes that the Agricultural Credit Department of the Reserve Bank of India can help in the creation of such a bank.¹ But it is doubtful whether the difficulties in the way have been fully considered. An All-India Land-Mortgage Bank providing long-term credit for the Provincial Land-Mortgage Banks may prove unwieldy. There may also be

1. See the Article contributed by Dr. P. S. Lokanathan to the Reserve Bank Inauguration Number of the "Indian Finance", p. 25.

administrative difficulties. If the All-India Land-Mortgage Bank is to finance the Provincial Land-Mortgage Banks, it must have some control over the latter. But the latter are controlled by different Provincial Governments in this matter. Again, the Provincial Land-Mortgage Banks are differently constituted and they do not adopt the same procedure in the matter of borrowing and lending long-term credit. This is a real difficulty, for the All-India Land-Mortgage Bank will insist on some uniformity in these matters. Is there, after all, need for an All-India Land-Mortgage Bank? The Provincial Land-Mortgage Banks may not experience any difficulty in raising the necessary long-term capital. Investors in India have always a special fondness for securities bearing a fixed rate of interest. The prices of such securities have not fallen even when the rates of profits in industries have tended to rise. This has been clearly seen in recent years.¹ There will always be a ready market for the debentures issued by the Provincial Land-Mortgage Banks, since the rate of interest is fixed and since there is adequate security. So the Provincial Land-Mortgage Banks can always raise the

1, P. C. Jain, "India Builds Her War Economy, (1943), pp. 104-106,

necessary amount of long-term capital by issuing debentures. Moreover, in future other sources of long-term credit may be available to them. We may expect our insurance companies to play a large part in providing long-term credit.¹

Land-mortgage banks in this country are generally conducted on a co-operative basis. Should land-mortgage banks be co-operative? This question is dealt with in Chapter IX.

Two different kinds of land-mortgage banks seem to be necessary in our country. There must be co-operative land-mortgage banks which will meet the needs of small landowners. These landowners will borrow long term loans from the co-operative land-mortgage banks, mostly for making permanent improvements to their lands. In addition, there must be commercial land-mortgage banks to accommodate big landowners. The Royal Commission on Agriculture in India recommended the establishment of such institutions.² The Central Banking Enquiry Committee too was in favour of such banks.³ These credit institutions will be large joint-stock land-mortgage banks dispensing large-term loans to big landowners.

1. See Chap. VIII, Sect. 3.

2 The Report of the Royal Commission on Indian Agriculture, para, 382.

3. The Report of the Central Banking Enquiry Committee, paras. 233-284.

If there are such joint-stock banks the bigger landowners will be able to borrow from them fairly huge sums of money for long periods on the security of their land. These long-term loans can be utilized for the liquidation of prior debt and for other purposes.

3

Credit institutions called house-building societies have been started in certain parts of India. They are of a co-operative character. The co-operative house building societies are also called co-operative housing societies. But co-operative housing societies are of two kinds. There is, first, the individual ownership society. This makes long-term advances to the members for building or purchasing houses. There is also the tenant ownership or co-partnership society. This society, which is conducted on a co-operative basis, owns houses which are let to members at low rents. But we are concerned only with the co-operative housing societies of the first type. These are credit institutions providing long-term loans. As already noted, they are also called co-operative house-building societies.

Co-operative house-building societies are found in the Madras Presidency, where they

are common. The other type of co-operative housing society is common in the Bombay Presidency.

I have studied at first hand the working of the Mercara Co-operative Building Society, Ltd. I find that it is in many respects a typical house-building society. I shall briefly describe the organization and working of this society. This will give some idea of house-building societies in general.

The main objects of the Mercara Co-operative House-Building Society Ltd., are the following:— (a) To build or own houses on behalf of the society. (b) To enable members to buy houses, to free houses from previous encumbrances, to build new houses, re-build, repair or overhaul their houses by means of loans advanced to them. (c) To co-operate with the Municipal Committee in schemes of extension and reclamation of old blocks of the town¹

By-Law 2 of the society requires every member to take up at least one share. Under By-Law 3 the liability of every member is limited to the share-capital subscribed by him.

By-Law 7 empowers the society to obtain funds from the following sources:—

1. See By-Law 1 of the society.

(1) Share subscription, (2) deposits, (3) loans, (4) fees.¹

Under By-Law 17 (a) a loan can be granted only on the security of a house or a house in course of construction or under repair, or on the security of a house site in the town. By-Law 17 (b) requires that all houses should be constructed according to the plans approved by the Board of Management.

Under By-Law 16 (b) the maximum loan that can be granted to a member is five times the paid-up share capital. The loans can be granted for long periods. But according to By-Law 13 (c) the maximum period is 20 years. Under By-Law 22 the amount borrowed can be paid back by monthly or other periodical instalments.

It is clear that co-operative house-building societies will be extremely useful to people living in towns and cities where dwellings are scarce and rents are high. Co-operative house-building societies should advance long-term loans for constructing new houses or for making repairs to existing houses. They should not advance long-term loans on the security* of house sites or houses for other purposes. Such loans should be

1. Every member pays an entrance fee, which depends on the number of shares purchased by him.

provided by Nidhis or by insurance companies.¹

It is doubtful whether co-operative house-building societies can be self-sufficient. In the Madras Presidency the Government had been financing the co-operative house-building societies, but the Government has withdrawn from the field.² They rely mostly on share-capital. They cannot hope to raise large funds by means of long-term deposits. It is, however, open to them to borrow loans from co-operative banks. The question arises whether there should be a separate apex bank in the case of co-operative house-building societies. If there is a central house-building society for the province as a whole, there will be no difficulty in financing the various house-building societies in the province. But this would lead to unnecessary duplication. It is easy to overdo the idea of a separate Provincial Co-operative Bank for each variety of co-operative credit.³

It is interesting to note that the Madras Government had under contemplation a

1. See below, Chapt VIII, Sect. 4.

2. See the Memorandum submitted by the late Mr. V. Ramadas Pantulu on the proposed Provincial Co-operative House-Building Society for the Presidency of Madras, p. 1.

3. *Ibid.*, p. 3.

Provincial Co-operative House-Building Society. But later the idea was given up, largely because it was opposed by leading co-operators like the late Mr. V. Ramadas Pantulu. From what co-operative banks can house-building societies borrow long-term loans? It is clear that they cannot borrow long-term loans from the Provincial Co-operative Bank or from the Central Co-operative Banks. These cannot provide long-term loans out of short-term deposits. Only the Central Land-Mortgage Bank can supply long-term credit to house-building societies. But just now owing to its special constitution it cannot finance house-building societies. It is, therefore, necessary to change the constitution of the Central Land-Mortgage Banks. As credit institutions, co-operative house-building societies can be as sound as the primary land-mortgage banks; like land-mortgage banks they lend money only on the security of immovable property. In every province there must be one central bank to finance primary co-operative land-mortgage banks and co-operative house-building societies.

4

As we have already seen,¹ long-term credit is of great use in industrial production. As a

1. See above, Chap. II, Sect. 1.

matter of fact, however, long-term loans are not required in many large-scale industries. They are managed by joint-stock companies, which can raise the necessary capital without having recourse to long-term loans.¹ In a few cases, loans may be borrowed even by the companies conducting large-scale industries. But these are exceptional cases.

Long-term loans may be required in the case of medium-sized industries and cottage industries. These are usually one-man businesses. A man running a small-scale industry may not own the necessary capital. In such a case a long-term loan will be of the greatest use to him. With the loan he can buy the necessary plant. The long-term loan can be easily repaid, because productive debt creates its own means of repayment. Many small-scale and cottage industries are languishing owing to lack of capital. We must create agencies which will finance these industries. At present, there is no properly organized system of industrial finance in India.

Many suggestions have been made in this connection. The General Banking Enquiry Committee submitted detailed proposals for

1. This subject has been fully discussed in Chap. II, Sect. 2.

the establishment of an Industrial Corporation. The Industrial Corporation may try to attract long-term deposits, but must rely on its share-capital. The share-capital should be supplemented by debenture capital. The Government may guarantee interest on the debentures. The Industrial Corporation should provide long-term credit to individuals and companies engaged in production.¹ The Bombay Banking Enquiry Committee made somewhat similar suggestions. There should be in the Bombay Presidency an Industrial Bank with branches throughout the Presidency. The smaller industries should be financed by the branches. These were among the suggestions made by the Committee in this connection.² Dr. P. S. Lokanathan has recommended the establishment of provincial industrial corporations, with branches. But these should not be allowed to finance all kinds of industries. They should finance only public utility industries.³ In 1936 the Bengal Legislature approved the scheme for an Industrial Credit Corporation. The Industrial Credit Corporation will provide loans for starting small-scale industries.⁴

1. The Central Banking Enquiry Committee Report, paras. 402-407.

2. The Bombay Banking Enquiry Committee Report, Para. 177.

3. Dr. P. S. Lokanathan, "Industrial Organization in India", (1935), p. 268.

4. N. Das. "Industrial Enterprise in India", pp. 135-140.

It is not necessary to discuss in detail these schemes. We have only to consider the principles underlying these schemes. It has been often proposed that long-term credit should be provided in the case of all important industries. But I believe much depends on the form of management. An industrial unit owned by a joint-stock company should rely solely on its share-capital. The share-capital must be obtained from the investing public. Of course, there must be agencies which will help it to obtain the necessary capital from the investing public.¹ The joint-stock company may, however, obtain its working capital from existing banks. In the case of industrial units owned by joint-stock companies, there is no need for industrial credit corporations providing long-term capital.

What about the major industries which are conducted by private individuals? Long-term loans may be required in the case of such industries. An individual who owns a large industrial unit may be in need of long-term capital. But it is doubtful whether any industrial bank will be prepared to lend to him large sums of money for the purpose of buying machinery and other things. The risk would

1. See above, Chap. II, Sect. 1.

be too great. An industrial credit corporation would naturally like to lend small sums of money to a large number of small producers rather than to lend large sums of money to a few big producers. It should not be expected to lend very large sums of money to big producers. They should seek other means of raising long-term funds.

But for some years to come it may be necessary to provide long-term loans for some of our major industries, whether these industries are run by private individuals or by joint-stock companies. At present when capital is somewhat shy, joint-stock companies conducting industries are not able to raise all the necessary capital by issuing shares and debentures. It is a well-known fact that many of the cotton mills in Bombay and Ahmedabad try to attract deposits from private individuals. This is one method of raising the necessary capital. But this method is fraught with danger, for the money deposited with the mills may be utilized for purchasing machinery. Money which is deposited for short periods should not be thus locked up. But this method is widely employed in Bombay and Ahmedabad.¹ This shows that there is

1. See the Interim Report of the Bombay Textile Labour Enquiry Committee, p. 58.

need for providing long-term credit for some of our major industries. The industrial banks may have to finance major industries too. But this will be a temporary arrangement.

The case of small-scale industries and cottage industries is different. These are not conducted by joint-stock companies, but by private individuals. There is great need for long-term credit. Industrial credit corporations may be expected to meet the needs of small producers and cottage industrialists. But the question of security has to be considered. This is a very important question, as the loans are long-term loans. What security can a small producer offer for the long-term loan he expects from an industrial credit corporation? It is usually the machinery he proposes to buy with the long-term loan. The borrower may have some immovable property of his own, and he may be prepared to offer this as security. But he should not be expected to offer this kind of security. If he is prepared to offer his immovable property as security he can obtain a long-term loan from some private individual, or from some land-mortgage bank or house-building society.¹ There is no need

1. I know of certain producers who have raised the necessary long-term capital by mortgaging their immovable property. But they got the loans from private individuals.

for industrial credit corporations in that case. Industrial credit corporations which exist for the purpose of providing long-term credit for industries must be prepared to lend on the security of machinery. But this kind of security does not fulfil all the conditions mentioned in Chapter I, Section 4. The machinery which is offered as security may be completely worn out by the time the loan becomes due. Even if it remains intact it may have little value at the end of the period; this will happen if there is over-production in the industry in which such machinery is employed, because in that case producers will not be willing to invest any money in such machinery. It must be remembered that the demand for machinery is a derived demand. Then there is the problem of marketing. This is a difficult problem indeed. If the producer who has borrowed a long-term loan is not able to market his products, he may not be able to pay interest regularly.

These difficulties have to be solved if industrial credit corporations for providing long-term loans for industries are to be a success. If past experience is any guide, industrial banks can never be a success in this country. The industrial banks which

were started in this country after the first world war failed miserably.¹ But we have to provide long-term credit for small-scale industries and cottage industries if these are to be developed. Therefore, we have to start industrial credit corporations for providing long-term loans for such industries. But we have to proceed cautiously. Long-term loans can be granted only under certain conditions. Loans should not be granted for more than 12 years at the most. The machinery which will be offered as security for a long-term loan may not be worn out at the end of that period. A period of 12 years is not too short, considering that the rate of profits in industry is fairly high. A man who invests a certain sum of money in an industry may be expected to recover the full sum in a period of 10 or 12 years. It is also necessary to recover the money by instalments. The risk will be less in that case. The producer who has borrowed a loan for 12 years may fare well during the first few years, but may be ruined in the end, if there is a sudden depression in that industry. If the loan is to be repaid by instalments, the whole of the money lent will not be lost. One other condition must be satisfied if a long-term loan is to be granted

¹ J. S. K. Muranjan, *op. cit.*, p. 163.

to a producer. There must be a steady demand for the products of his industry. It is clear that industrial credit corporations cannot provide loans for newly started industries. There must be a separate agency for financing such industries.¹

Even when all possible precautions are taken, there is great risk in lending long-term loans to small producers and cottage industrialists. Co-operation among producers will be a great advantage. A handloom weaver who is a member of a loan-and-sale society is better able to market his products than one who is not a member of such a society. What is more, he will get a higher price for his products, because he gets a part of the profits which would otherwise go to the middleman. An industrial credit corporation can lend a long-term loan to such a producer without much risk. He may buy a new loom with the loan. He is assured of a market for his products, because it is sold through the loan-and-sale society. The society will provide him with working capital. Every year he will pay to the industrial credit corporation from which he has borrowed the long-term loan interest as well as a part of the principal. The loan-and-sale society of which he is a

1. See below, Chap. VII, Sect. 2.

member may be expected to help the industrial credit corporation in collecting the annual instalments.

The need for such industrial credit corporations has been felt even in England. There investors are generally prepared to invest their money in stocks and shares. Most industrial units are owned by joint-stock companies which can raise the necessary capital by issuing shares. In spite of this it has been found necessary to start industrial credit corporations of the type mentioned above. One company, named the Finance Corporation for Industry Limited, has a capital of £ 25,000,000/- and has borrowing powers of four times that amount. The purpose of the company will be to provide short-or long-term credit for industrial businesses of the country. A second and smaller company, the Industrial and Commercial Finance Corporation Limited, with a capital of £ 15,000,000/- and borrowing powers of twice that amount, will provide medium-and long-term capital for small and medium-sized businesses.¹

The need for such industrial credit corporations is greater in India. There must

1, "The Times of India", 25th January, 1945.

be in each province an Industrial Credit Corporation with branches. It is neither possible nor desirable to have in each province a number of independent industrial banks. It is necessary to adopt a uniform policy in the matter of providing long-term credit; the industrial development of the province must proceed according to a certain plan. These things will be possible only when there is *one* industrial bank in the province. Of course, the bank must have a sufficient number of branches. The Industrial Credit Corporation will obtain its working capital from three sources: (1) Share-capital, (2) long-term deposits, (3) debentures. It will obtain its capital mostly from debentures. It will be necessary for the Government to guarantee interest on the debentures, especially as the Industrial Credit Corporation cannot be run on strictly business lines. It may also be necessary for the Government to buy a certain proportion of the shares issued by the Industrial Credit Corporation. The Industrial Credit Corporation will supply its branches with funds. But the latter may try to attract long-term deposits. These branches will not be in the same position as the land-mortgage banks in the districts. The branches of the

Industrial Credit Corporation will not be independent institutions which derive a part of their working capital from an apex bank; they will be merely branches of a central organization.

CHAPTER VII

THE SOURCES OF LONG-TERM CREDIT- (concluded)

1

In this chapter we shall consider the part which Government can play, or rather ought to play, in the provision of long-term credit. It is not suggested that every Government is by duty bound to provide long-term loans for those who are in need of such loans. Under no system of government can the Government be regarded as a normal source of long-term credit. Long-term credit should normally be supplied by credit institutions which exist solely for the purpose of providing this form of credit. But the conditions under which they work are such that they may require some help from the Government. When and how should the Government help them?

The nature of the help required will be apparent when we consider the principle on

which credit institutions like land-mortgage banks are conducted. Any institution which exists for the purpose of providing long-term loans must derive a large part of its working capital from debentures.¹ That is the best way of raising long-term funds. Here a difficulty arises. The debentures must be sold to the public. But in India, where capital is shy and the investment habit has not been fully developed, all the debentures may not be taken up by the public. In that case the Government must take up at least a portion of the debentures if the credit institutions for providing long-term credit are to work successfully. Fortunately, some Provincial Governments in this country have realized the need for such an arrangement. In Madras, the Government had to take up a large portion of the debentures issued by the Central Land-Mortgage Bank. The Government of Bombay had to adopt a similar arrangement.² This is the least that the Government should do in the matter of supplying long-term credit to the agriculturists. The Government should not be expected to lend directly to the Central Land-Mortgage Bank. But it should help it

1. See above, Chap. VI, Sect. 1.

2. See Jathar and Beri, "Indian Economics", Vol. I, (1942 ed.) pp. 376-377.

to raise long-term funds by buying a portion of the debentures issued by it. Of course, the Government may have to guarantee the interest as well as the principal in respect of the debentures issued by the Central Land-Mortgage Bank.¹ But here we are considering the Government as a source of long-term credit. It can provide long-term credit *indirectly* by taking up a portion of the debentures floated by the Central Land-Mortgage Bank.

In some special cases, however, it may be necessary for the Government to lend directly to borrowers who are in need of long-term credit. As we shall see later, some Provincial Governments lend long-term loans in some cases. But the policy pursued by the Provincial Governments in this matter has not been carefully thought out. There must be a method in the policy to be pursued by Provincial Governments in the matter of providing long-term loans, and the policy adopted by the Governments should not result in unnecessary duplication. Two questions have to be considered. Does the Government as an agency for supplying long-term credit possess any special advantages? In what

2. See above, Chap. VI, Sect. 1.

particular cases will it be necessary for the Government to lend directly to borrowers who are in need of long-term loans?

Let us first consider the question whether the Government as an agency for providing long-term loans possesses any special advantages. It is generally believed that the Government is the only agency which can provide long-term loans at very low rates of interest. The Government, it is said, can borrow huge sums of money at a very low rate of interest. Since the cost of dispensing long-term loans is negligible,¹ and since the Government does not make a profit out of this business, there need not be any difference between the borrowing and lending rates of the Government. This, of course, is true at present. Even when a terrible war was raging and the world was passing through a crisis, the Central Government and the Provincial Governments had not much difficulty in borrowing huge sums of money for long periods at low rates of interest. The rate of interest in the case of loans floated by the Governments in this country is not more than 3 or 3½ per cent. The Government of

1. There need not be a separate establishment for dispensing such loans. The loans may be disbursed by some of the existing Departments of the Government.

India is not required to pay more than 3 per cent interest on loans borrowed between 1940 and 1943. There is, for instance, the 3 per cent loan, 1943-45 (special issue).¹ At present Provincial Governments may have to pay 3½ per cent interest on loans floated by them. As an agency for providing long-term credit the Government of a province is in a peculiarly favourable position. If the Government raises long-term funds and provides long-term loans out of these funds, the borrowers of long-term loans will be able to utilize the credit enjoyed by the Government. But we should not assume that the position will always remain the same. If all long-term loans are supplied by the Government the Government will become the greatest borrower, and the Government's credit may suffer. People who lend money to the Government may not doubt its solvency, but they may doubt its ability to recover the loans advanced by it. The Government may have to pay high rates of interest in the case of loans borrowed by it. This means that the Government will have to charge higher rates of interest on loans advanced by it. This does not occur to many of those who want the Government to lend

1. Prof. L. C. Jain, "Indian Economy During the War" (1944). p. 110.

directly to agriculturists and others. But for the present at least the Government is in a position to provide long-term loans at low rates of interest.

This advantage the Government enjoys in the case of every form of credit. But it enjoys certain special advantages in the matter of providing long-term credit. The Government, for instance, can lend for very long periods; it can lend a loan for 100 years. A credit institution like a land-mortgage bank can lend for long periods, but not for such a long period. As we shall see later, in some cases it is necessary to lend loans for very long periods. Another advantage is this. It is only the Government which can provide long-term credit on a large scale. If, for any reason, it becomes necessary to provide long-term loans for a very large number of people, a huge amount of money has to be raised. (As we have seen, only large sums of money are lent for long periods). Only the Government is capable of raising the large funds that would be required in such a case. And the Governments in this country are not averse to borrowing huge amounts. Consider, for instance, the 3 per cent First Development Loan, 1970-75 recently floated by the Government

of India. Recently the Government created a further issue of the loan for Rs. 30/- crores.¹ Nor is this all. The Government may be expected to exercise the greatest care in the matter of lending long-term loans. There is the danger of facile credit. This danger is particularly great in the case of long-term loans.² The Government may be expected to make long-term advances only in deserving cases. What is more, the Government will see that the long-term loan is of real help to the borrower. It will not allow the loan to be misused. This is a matter of the greatest importance. The Madras Government has framed rules for the grant of loans for the relief of indebtedness under the Agriculturists' Loans Act, 1884, as amended by the Madras Act XVI of 1935. Some of the rules appear to be ideal. For instance, no loan shall be granted to any person unless he applies for an amount which would be sufficient to discharge all his liabilities.³ The loan, when sanctioned, is to be disbursed direct to the creditors concerned.⁴ If a long-term loan is to be a success, these rules

1. "The Times of India", 3rd July 1945.

2 See above, Chap. I, Sect. 2.

3. See Rule III (1) of the Agriculturists' Loans Act 1884, as amended by the Madras Act XVI of 1935.

4. See Rule VI (2) (b).

must be strictly enforced.¹ The Government as an agency for providing long-term loans possesses one other advantage. It can recover the long-term loans advanced by it with greater ease. Whenever the Government advances long-term loans, the borrowers are mostly landowners. (People who do not own land cannot ordinarily secure long-term loans from the Government). The loans are to be repaid by instalments and instalments can be collected along with the land revenue. This is an advantage to the Government as well as to the borrower. The Government will be saved much trouble and cost, and the borrower will be paying the instalments regularly, although in some cases against his will. If the instalments are not paid at the proper time, they can be recovered in the same way as arrears of land revenue. As we have seen, a long-term loan can never be a success if the instalments are not paid regularly.²

Thus the system under which long-term loans are obtained through the agency of the Government has much to commend it. But still the Government should not be regarded as a normal source of long-term credit. It is only in a few special cases that the Government

1. See above, Chap. I, Sect. 3.

2. See above, Chap. I, Sect. 3.

will be required to provide long-term loans. Let us consider these cases.

2

The problem of industrial finance was discussed in Chapter VI, Section 4. We have seen that, under a fully developed system of long-term credit, industrial banks or industrial credit corporations will provide long-term credit for certain classes of industries. They will finance small-scale industries and cottage industries, which are thriving and which are likely to survive. They cannot be expected to provide long-term credit for industries which have been newly started and for industries which are yet to be started. The risk in these cases would be too great; we must remember that an industrialist who borrows a long-term loan is rarely in a position to offer proper security. Very often the only security which he can offer is the machinery which he buys with the long-term loan. But our country is vast, our resources in men and materials are unlimited, and there is always need to start new industries. Many of them will be small-scale industries or cottage industries. Even the authors of the so-called Bombay Plan have admitted the need for small-scale and cottage

industries in our country. These industries will have a place in the industrial system recommended by them.¹ How are we to finance these industries? They will not be run by joint-stock companies.

It will be generally agreed that in such cases it is the duty of the Government to provide the necessary long-term capital. But we must at the outset make a distinction between major industries and minor industries. Major industries which have been newly started, or have yet to be started, may have to be financed by the Government, especially if they are public utility industries. This does not necessarily mean that the Government should provide long-term credit for these industries. Such industries will be for the most part conducted by joint-stock companies. The Government can finance these companies otherwise than by lending long-term loans to them; it can help them to acquire the necessary long-term capital by buying a certain number of shares issued by them. Some Governments in India have adopted this policy, and the results have been encouraging. It would be superfluous to give instances.

1. See "A Plan of Economic Development for India" by Sir Parshotamdas Thakurdas and others, Part I, (1944), pp. 27-28.

What about nascent small-scale industries and cottage industries? The Government must give financial assistance to such industries. In this case the Government may have to provide long-term loans which are to be repaid by easy instalments. In fact, many Provincial Governments have been granting loans to persons engaged in industry. They can grant such loans under the State-Aid to Industries Act. State-Aid to Industries Acts have been in force in Madras, the Punjab, Bengal and the Central Provinces. In Bombay the Government can provide long-term loans for industries under the State-Aid to Small Industries Rules.¹ These Acts, however, have not been of great use to any class of industries. In Madras the State-Aid to Industries Act has been in force since 1923. What is the experience of the Madras Government? The Report of the Madras Department of Industries for the year ending March, 1935 says that the Act has not led to any remarkable results in the industrial field.² This only means that the rules for the grant of loans under the State-Aid to Industries Act have to be changed. Under Section 13 (2) of the Madras State-Aid to Industries Act the maximum period for

1. See Jathar and Beri, "Indian Economics", Vol. II (1941 Ed.), pp. 21-22.

2. Ibid, p. 22.

which a loan can be lent is 20 years. But the Provincial Government can, by general or by special order, extend the period. Thus loans can be lent to industrialists for very long periods. But an industrialist who wants a long-term loan cannot be sure of getting such a loan from the Government. Much depends on the nature of the security offered by him. An industrialist who cannot offer some immovable property as security has little chance of getting a long-term loan. But it is wrong to expect industrialists to provide security of this kind. It will be generally agreed that the loans granted by the Government under the Act must be long-term loans. The Government must provide long-term loans for nascent industries; it must also provide long-term loans for starting new industries. The rate of interest should be as low as possible and the loans should be repayable by instalments. In this case, the Government cannot be very particular about the security, although in the case of long-term loans the question of security is very important. The only security which it can expect is the machinery which can be bought with the loan. It is precisely because a cottage industrialist cannot furnish proper security for a long-term loan that the Government should finance him,

There is no alternative to this arrangement. Whatever the policy adopted by the Government with regard to industrial finance, long-term credit for newly started small-scale industries and cottage industries must of necessity be supplied by the Government. No industrial bank is prepared for the risk involved in financing such industries. It is idle and unwise to deny this fact and to shirk its obvious implications. Moreover, since the Government is responsible for the industrial development of the province, only the Government is competent to decide which of the newly started minor industries are to be helped by means of long-term loans. Only the Government can decide what new minor industries have to be started. No other credit agency can provide long-term loans for starting such industries. The idea of the Government providing credit for certain classes of industries is not a new one. The French economist Louis Blanc, a great believer in co-operation, believed that industries could be conducted by co-operative societies of persons engaged in production. He wished the Government to supply the necessary capital. The Government was expected to borrow the capital. The

interest on the capital should be guaranteed against taxation.¹

3

We have already seen that there is a great need for long-term credit in agriculture.² An agriculturist who has some land of his own usually does not have much difficulty in obtaining a long-term loan. But the agriculturist who does not own the land he cultivates is in a peculiar position. He cannot hope to get a long-term loan, because he cannot furnish any security. But such a man may require a long-term loan for purchasing agricultural machinery. No credit agency, I believe, is prepared to lend a long-term loan to this agriculturist solely on the security of the machinery he will purchase with the loan. And yet it is necessary that he should be provided with a long-term loan. If he is honest and hardworking he will make the best possible use of the loan. Every year he will pay interest as well as a part of the principal. This he can easily do as he will be able to produce more with the help of the machine he has bought. It is only the Government that

1. See Gide and Rist, "A History of Economic Doctrines", (English Translation), p. 259.

2. See above, Chap. II, Sect. 4.

can afford to grant long-term loans in cases of this kind. In the interests of agricultural development the Government as a credit agency must provide long-term loans even where security of the proper kind is not furnished by the borrowers. The Madras Government lends loans to agriculturists for the purchase of machinery. A loan can be lent on the security of the machinery or plant for the purchase of which the loan is granted. But a loan which is lent on such security cannot be lent for more than 5 years.¹ It is only when the loan is secured on landed property that it can be repaid by 20 annual instalments.² Now in a case of this kind the loan must be necessarily lent for long periods. It can be easily repaid only when it is lent for long periods. But the risk involved in advancing long-term loans to cultivators for the purchase of agricultural machinery is very great. Such loans can be granted without much risk to co-operative societies consisting of cultivators. A co-operative society consisting of cultivators is more reliable than a single cultivator. There is

1. See Rule XV (b) (2) of the Madras Land Improvement and Agriculturists' Loans (Pumping Installations and Agricultural Machinery or Plant) Rules.

2. See Rule XV (b) (1).

no reason why co-operative farming should not be tried on a large scale. It is a solution for fragmentation, and subdivision of holdings. It is only under co-operative farming that agricultural machinery can be employed on a large scale. A single agriculturist cultivating a small strip of land cannot hope to employ any agricultural machines, but a co-operative society which is responsible for the cultivation of a large farm can employ agricultural machinery. Such a co-operative society can reasonably expect to obtain from the Government a long-term loan for purchasing agricultural machines. The loan in this case can be granted solely on the security of the machinery purchased. Probably co-operative farming will become more common in future.

What about long-term loans for agricultural improvements? Some Provincial Governments grant long-term loans for agricultural improvements under the Land Improvement Loans Act of 1883. Strictly speaking, there is no need for such loans from the Government. Such loans are best provided by land-mortgage banks. Under the Indian systems of land tenure an agriculturist will not make any permanent improvements to his

land, if he does not own the land which he cultivates. In every case, the improvements are made by the owner. If the owner wants a long-term loan for making improvements to his land, he can get such a loan from the nearest land-mortgage bank. Land-mortgage banks exist mainly for that purpose. Of course, in areas not covered by land-mortgage banks the Government will have to provide long-term credit for agricultural improvements. But we are thinking of the time when India will have a highly developed system of long-term credit.

4

In one particular case the Government may be regarded as a normal source of long-term credit. Of late the agricultural marketing has been receiving greater attention. Co-operative sale societies have been started in many parts of the country. But these societies suffer from one or two handicaps. Many of them cannot provide themselves with godowns, where the agricultural produce can be stored. As everyman who has some idea of agricultural marketing in India knows, such warehouses are absolutely essential. It is of the greatest importance to provide our agriculturists with warehousing facilities. If such facilities do

not exist, the agriculturists cannot hold their produce against a rise in price; they must sell their produce as soon as the crops are harvested, whatever the prices offered. They cannot wait till prices rise, as they have no reserve capital. But if warehousing facilities exist, they can obtain advances from co-operative societies against warehouse certificates, and they will wait till they can get a higher price for their produce. But very few co-operative sale societies own godowns and very few have the funds necessary for constructing such godowns. It is clear that long-term loans at low rates of interest will enable them to construct godowns. But who is to provide such loans? Neither land-mortgage banks nor house-building societies can be expected to advance loans to these societies. The Government seems to be the only agency which can provide such loans. The Central Banking Enquiry Committee recommended that Provincial Governments should provide long-term loans at concessional rates of interest for constructing godowns at important centres. This is a matter of the utmost importance and has been treated at some length in the Report of the Central Banking Enquiry Committee.¹ It is encouraging to note that the Government of Madras

1. The Central Banking Enquiry Committee Report, paras. 279-82.

is advancing long-term loans to co-operative sale societies for constructing godowns.¹

5

There is one other case in which a regular supply of long-term credit from the Government may be necessary. If more and more land is to be brought under cultivation in this country, a regular supply of long-term credit must be forthcoming from the Government. New land cannot be brought under cultivation if the men who are to be settled on the land are not provided with the necessary long-term capital. The Government must lend long-term loans at specially low rates of interest, and the money must be recovered by easy instalments. The instalments can be collected along with the land revenue which the cultivators will be called upon to pay. At present very few Provincial Governments are providing long-term loans for this purpose. But the time has come when new agricultural colonies have to be started. Every available acre of land has to be cultivated to raise food for a growing population and to relieve the pressure of population on the land. All schemes of colonization have to be financed by the

1. The Madras Banking Enquiry Committee Report, para. 71.

Government. No other credit agency is in a position to supply long-term credit for starting new agricultural colonies.

6

The question whether the Government should provide long-term loans for the liquidation of prior debt has not been fully discussed. Many economists and publicists in this country expect the Government to play a large part in the liquidation of rural indebtedness. Under the Agriculturists' Loans Act of 1884 loans cannot be granted for the liquidation of old debts. But the Act can be suitably amended. It was amended in Madras in 1935. (It was amended by the Madras Act XVI of 1935). This amendment permits the granting of long-term loans for the liquidation of prior debt. Thus the Madras Government lends long-term loans for the liquidation of prior debt under the Agricultural Loans Act, 1884 as amended by the Madras Act XVI of 1935. The Provincial Governments have taken it upon themselves to liquidate rural indebtedness. But this appears to be a fruitless task; one sometimes despairs of liquidating rural indebtedness. The

Government cannot solve the problem of rural indebtedness by granting long-term loans for the payment of prior debt. The Government must rather treat the causes of rural indebtedness. I do not suggest that an agriculturist who has borrowed loans at a high rate of interest should not be provided with a long-term loan on easy terms. But such loans can be provided by private individuals or by land-mortgage banks. Just now there may not be enough land-mortgage banks in the country. But here we are dealing with things as they ought to be and not with things as they are. In normal times the Government should not be called upon to provide long-term loans for the liquidation of prior debt.

But a situation may arise in which the Government will be required to provide long-term loans for the relief of rural indebtedness. Such a situation will arise if the Government adopts any scheme of debt relief. Suppose under the scheme the rates of interest to be paid by agricultural debtors are reduced. The debtors will not get any relief so long as they are not in a position to pay their creditors; the creditors will secretly charge the old rates of interest. If the debtors insist on paying interest at the rates allowed under the

scheme of debt relief, the creditors will demand their money back. This they cannot do in the case of loans for fixed periods; but they may not renew the loans when they fall due, and how many agricultural debtors will be in a position to repay the loans? The result is that they do not get any relief. In a situation like this the Government must come to the rescue of the debtors. They must provide the debtors with long-term loans. This will enable them to pay off their debts.

Agricultural debtors in the Madras Presidency would have secured greater relief under the Madras Agriculturists' Relief Act if they had been in a position to pay their creditors. Many of them could not pay their creditors; so they were in the clutches of their creditors. These debtors did not get any relief from the exactions of the creditors. It was clearly the duty of the Government to provide long-term loans for the liquidation of prior debt. In the Budget for the year 1938 the Government did provide a sum of Rs. 50 lakhs for the relief of indebtedness. But this was inadequate. I remember that the Government was severely criticized by many politicians, publicists and economists for its failure to make adequate provision for the

relief of indebtedness. The Act, it was said, was a dead letter.¹ In a case like this the Government need not provide all the agricultural debtors with long-term loans.² The creditor will come round if he knows that the debtor can, if necessary, get a long-term loan from the Government at a low rate of interest; very often the threat to repay the loan brings the creditor to his knees.

7

We must now consider the part which the Government can play in the provision of long-term loans for purchasing agricultural land. If a landowner who has no cash with him just now wishes to purchase a plot of land, he can obtain a loan from an individual or a credit institution on the security of the land which he already owns. But a tenant who has no land of his own is in a different position. He cannot hope to obtain a loan from any individual or credit institution for purchasing

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1. It is only fair to note that many agricultural debtors did secure some relief under the Act.
 2. It is only in a small State like Bhavanagar that the Government can hope to provide long-term loans for all the agricultural debtors. In Bhavanagar a total debt of Rs. 86 lakhs has been compounded for Rs. 20.5 lakhs, and the Government has paid the whole of it. It hopes to recover it in easy instalments. See "Economic Problems of Modern India", Ed. Radhakamal Mukerjee, Vol. I, (1939), Chapter IX, p. 177. Chapter IX has been contributed by Dr. P. J. Thomas and deals with rural indebtedness.

a plot of land. Even if he gets a loan from a credit institution or an individual, the loan will not be of much use to him. What he needs is a long-term loan on the most favourable terms. The loan must be for a very long period indeed; the loan probably cannot be repaid in the life-time of the borrower; it may be repaid in the second or third generation. The loan must be recovered by easy instalments spread over a very large number of years. The rate of interest must be very low; otherwise the tenant who purchases the land will not find it profitable to own the land. In India rents are generally below the current rates of interest. This is particularly true at the present time, when agricultural land is sold at fancy prices. If there is any agency which can provide a tenant with a long-term loan for purchasing agricultural land, it is the Government. Here the advantages which the Government as an agency for providing long-term loans possesses are clearly seen. It can lend a loan for a sufficiently long period in this case. The rate of interest will be very low. Moreover the loans can be easily recovered by the Government. The annual instalments can be collected along with the land revenue which the purchaser will have to pay. But

everything depends on the agrarian policy of the Government. If it is the intention of the Government to encourage tenant-cultivators to purchase agricultural lands whenever and wherever possible, it should provide these tenant-cultivators with long-term loans at low rates of interest so as to enable them to purchase the lands. There is no reason why such a policy should not be deliberately pursued by the Government. This seems to be the only solution for the many problems which have arisen under our complicated system of land tenure. The Government may similarly provide peasant-proprietors with long-term loans for purchasing agricultural lands, if this results in consolidation of agricultural holdings. At the present time most of the holdings owned by peasant-proprietors are uneconomic; they may be allowed to buy plots of land in their neighbourhood if this does not result in uneconomic holdings elsewhere. In these two cases the Government may be required to provide long-term loans for purchasing agricultural land. The idea is not new. In Great Britain, the Government has provided long-term loans for small farmers for purchasing agricultural land. The loans have been provided through the County Councils. The

Small Holdings and Allotments Act of 1908 empowered the Government to take all the land which any individual owns in England and Wales in excess of 50 acres and to sell it or lease it to a farmer or labourer. When a farmer or labourer buys an agricultural holding, only half of the price need be paid in cash; the balance may be secured by a mortgage to be paid off in half-yearly instalments. The longest credit which a County may allow on such a sale is 50 years.¹ In Ireland the Government has appointed "Estates Commissioners" under the Land Purchase Acts. These help the farmers to acquire the lands they cultivate by providing long-term credit. According to Herrick, these Commissioners constitute "the greatest body not only in Ireland but in the world for using the aid and credit of the State for the purpose of enabling the farmers to acquire real estate".² To-day practically all the farmers in Ireland are the owners of the land which they cultivate.

8

It has been worth while to consider the many cases in which the Government may be

1. "Rural Credits" by Herrick. Quoted in the Central Banking Enquiry Committee Report, para. 247.

2. Ibid.

expected to provide long-term credit. We have seen in what particular cases the Government should ensure a regular supply of long-term credit. Long-term credit differs from short-term credit. Under an ideal system of short-term credit, short-term credit will be supplied by banks (commercial and co-operative banks) and by some other credit institutions. There will be no need for the Government to provide short-term loans, whether for agriculturists or for others. But this is not true of long-term credit. Whatever our system of credit, long-term credit must in some cases be supplied by the Government. And this follows from the nature of long-term credit. But the Government should not lend long-term loans indiscriminately. This would lessen its usefulness as an agency for providing long-term loans. Whatever long-term funds the Government can raise must be properly utilized. The resources of the Government should not be frittered away. So far as the provision of long-term credit is concerned, the Government should concentrate on a few things, and provide long-term loans only for these things. At present the Government is lending rather indiscriminately. The result is that as a credit agency it has not been of any great assistance to the actual tillers of the soil. The Central

Banking Enquiry Committee commented upon the very insignificant part played by the Government in the matter of supplying credit to agriculturists.¹

CHAPTER VIII

LONG-TERM CREDIT AND INSURANCE.

1

Insurance has apparently nothing to do with long-term credit. Insurance, as a business transaction, does not involve the use of long term credit. But it has something to do with long-term credit. There can be some connection between that business transaction called insurance and the borrowing of a long-term loan. Again, insurance has much to do with the provision of long-term credit. But these things have not been fully investigated.

In obtaining a long-term loan the greatest difficulty is the difficulty regarding security. A man who wishes to obtain a long-term loan must furnish security, and the security must be of a particular kind. The only security which is accepted is immovable property of some kind. The man who does not own any immovable property evidently cannot hope to

1. The Central Banking Enquiry Committee Report, para 236.

get any long-term loan. But he can overcome this difficulty by insuring his life and by offering the life policy as security for the loan. As security for a long-term loan a life policy satisfies all the conditions satisfied by immovable property. But there are many practical difficulties. These difficulties have been fully discussed. Many people refuse to believe that a man can borrow a long-term loan on the security of a life policy on his life. But it is wrong to suppose that a life policy can never be security for a long-term loan. As we have seen, in certain cases a long-term loan can be granted on the security of a life policy without very great risk.¹ Here insurance has something to do with long-term credit.

A life insurance policy may be offered as *collateral* security for a long-term loan. If the immovable property which is offered as security for a long-term loan is not considered to be sufficient security by the person or individual lending the loan, the borrower may undertake to take out an endowment policy on his life and assign it to the person or institution from which he wishes to borrow. The Bombay Provincial Co-operative Land-Mortgage Bank welcomes such an arrangement whenever the

1. See above, Chap. IV, Sect. 1.

security offered in the case of a long-term loan is insufficient. Under By-Law 60 of the Bank, the Bank is to be the sanctioning authority in respect of loans to members of primary societies. But under this By-law preference shall be given to loans "in which the borrowers agree to take out endowment policies on their lives and pay regularly the premia thereon and to assign the policies to the primary bank as additional security." It may be said that there is nothing special about this. It is true that a life policy may be offered as collateral security for a short-term loan too. But in the case of a short-term loan security is not such a great matter. The fact that a life policy may be offered as additional security is of greater significance in the case of long-term credit than in the case of short-term credit, and is one more proof of the connection between long-term credit and insurance.

2

In the cases mentioned above the risk involved in *lending* a long-term loan without security of the usual kind can be eliminated by insurance. In the event of the borrower's death, the lender gets his money from the insurance company and he does not suffer any

loss if the sum assured is equal to the sum borrowed. Similarly, the risk involved in *borrowing* a long-term loan can be eliminated by insurance. But what is the nature of the risk involved in *borrowing* a long-term loan? A long-term loan is almost always secured by a mortgage of immovable property. A man who borrows a long-term loan borrows it on the security of his house or estate. What are his chances of redeeming the mortgaged property? If the borrower dies before the loan is repaid, his family will not get his property free of encumbrance. But if the borrower lives to repay the loan, his family will not suffer; on his death they will get his immovable property free of encumbrance. This is the risk involved in borrowing a long-term loan. Even a short-term loan may be secured by a mortgage of immovable property. But the risk is negligible in the case of a short-term loan. Clearly the risk is very great in the case of a long-term loan. This risk also can be eliminated by insurance. This is popularly known as *dismortgaging land-mortgage loans by insurance*.¹

1. The South India Co-operative Insurance Society Ltd. has introduced two schemes of *dismortgaging land-mortgage loans by insurance*. Details of the scheme are given in a pamphlet issued by the Society in 1939. The pamphlet is entitled "*Co-operative Land-Mortgage Banks and Co-operative Insurance*".

One way of doing this is very simple. A land-mortgage bank which lends a long-term loan on the security of the estate of the borrower will persuade the borrower to take out an insurance policy for the sum borrowed. The policy will be assigned to the bank. In the event of the premature death of the borrower, the bank will restore the property of the borrower to his family free of encumbrance.

But such an arrangement may sometimes lead to complications. If the man who borrows the long-term loan does not enjoy a sufficiently large income, he will have great difficulty in paying the premiums regularly; if he pays the premiums regularly, he may not be able to pay the annual instalments. Or, he may borrow a loan now and then and pay both the premiums and the annual instalments regularly. But the loans he has borrowed may result in a long-term loan. He may end by mortgaging another part of his immovable property!

There is a more interesting and ingenious way of dismortgaging land-mortgage credit. This is called dismortgaging by guaranteeing payment of the loan outstanding on the date of the death of the borrower. In this case the borrower does not get any money from the

insurance company at the end of the period for which the loan is made. If, however, he dies before the loan is repaid, the insurance company will pay to the land-mortgage bank from which the loan was borrowed that portion of the loan which remains unpaid at the time of his death. His family will thus get the mortgaged property free of encumbrance. Suppose a person aged 20 takes out a loan of Rs. 1,000/- from a primary land-mortgage bank. If the debt is to be liquidated in 20 years, and if the rate of interest is $6\frac{1}{2}$ per cent, he will be called upon to pay each year an equated instalment which will come to Rs. 90 - 12--0. If he takes out an insurance policy under the scheme described above, he has to pay an insurance premium of Rs. 8--2--0 every year in addition to the annual equated instalment, or he can pay the whole of the insurance premium in one single instalment. In that case he has to pay to the insurance company Rs. 87--5--0 at the outset. If he dies during the currency of the loan, the balance due to the land-mortgage bank from which the long-term loan was borrowed will be paid by the insurance company.¹ This scheme of

1. This illustration is taken from the above-mentioned pamphlet (see page 5). The rates mentioned are the rates actually charged by the South India Co-Operative Insurance Society Ltd., Madras.

dismortgaging land-mortgage loans is much cheaper and much more convenient for the borrower. It is free from the difficulties which exist in the case of the scheme noticed above. But in this case it is absolutely necessary that the long-term loans must be repaid by instalments. As the instalments are paid the risk to the insurance company will be constantly reduced. Only in that case will the insurance company undertake the risk implied by the arrangement. It is also necessary that the instalments must be regularly paid.

Several things are necessary if these schemes are to succeed. The land-mortgage bank must take a genuine interest in the borrower. But it may be expected to take an interest in the borrower if it is a co-operative institution. It is also necessary that the bank should co-operate with the insurance company with which the borrower has insured. The bank must undertake to collect the premiums along with the instalments to be paid by the borrower to the bank. Such co-operation between the land-mortgage bank and the insurance company is possible only when both of them are co-operative institutions. There must be a co-operative insurance society in

every province. This must work in alliance with the co-operative land-mortgage banks in the province. Then it becomes possible to link land-mortgage credit with insurance.

It is interesting to note that one insurance firm in Madras has introduced these two schemes of dismortgaging land-mortgage loans by insurance. That is a co-operative insurance society. I am referring to the South India Co-operative Insurance Society, Ltd.¹ I do not know how many insurance companies in India have introduced such schemes.

3

Insurance has much to do with the provision of long-term credit. Insurance companies are at all times in a position to provide long-term credit on a big scale. This follows from the nature of the business transacted by insurance companies. It is quite obvious that over a period the majority of the people who insure do not suffer from the contingency insured against. This needs no proof. It is quite clear from the fact that insurance companies on the whole gain more than they lose. Those who do not suffer from the contingency insured against will receive from

1. See the pamphlet referred to above, (pp. 3 to 5).

the insurance companies the sums assured (at least a large portion of such sums) when their policies mature. But in every one of these cases a long interval will elapse between the payment of the first premium and the last premium. This means that the earlier premiums can be invested at long term. So the first few premiums paid by the policy-holder can, in the majority of cases, be lent for long periods. In theory insurance companies are among the best agencies for providing long-term loans.

Let us consider the actual position. Today a large portion of the funds belonging to insurance companies has to be invested in a particular way. Certain definite modes of investment are prescribed by the Indian Insurance Act of 1938. Thus only a limited portion of the funds which can be invested by an insurance company can be lent for long periods; a large portion of the funds has to be invested in a particular way.¹

This, however, is not a great difficulty. If it is found that the best way of investing the funds is to lend them for long periods on good security, the Insurance Act can be suitably amended. Indeed, many people who are interested in long-term credit favour such an

2. See Section 27 (1) of the Indian Insurance Act, 1938, as modified upto 28th July, 1941,

arrangement. The insurance companies, it is said, can lend long-term loans to agriculturists on the security of their land with advantage to themselves and the agriculturists. The late Mr. V. Ramadas Pantulu, a great authority on co-operation and credit, was of this opinion. This is what he wrote on the subject in a memorandum which he specially prepared for me: "Insurance companies operate not only in towns but also in rural areas and tap agriculturists' resources for their business. So their funds which are long lying can be advanced as long-term loans to agriculturists and other classes who have the requisite repaying capacity, particularly to members of co-operative banks. The insurance companies have a wide-spread organization of branch offices and agents to appraise the value of the securities offered and also to collect the instalments of loans. The concerned co-operative banks also will take similar precautions regarding collections. Under this scheme the insurance companies lend some portion of their premium income from rural areas to agriculturists and others at much cheaper rates of interest than land-mortgage banks. In the case of land-mortgage banks there are three interests - the debenture holders who lend, the

Central Land-Mortgage Bank which issues the debentures, and the primary bank which directly lends to the borrowers. Between these three agencies a large margin is required in order to build reserves and meet the working expenses. But an insurance company can lend directly a portion of its premium income and does not require the same margin. In this way the insurance companies can help the people by advancing long-term loans on good security. It is certainly feasible. But it takes time for the idea to catch. There must be some enthusiasts to promote the rural interests, at the helm of affairs of large insurance companies. For instance, if the Oriental, Empire of India or the Laxmi Insurance Companies take up such a scheme they can easily make available a few crores of rupees by way of advancing long-term loans without the intervention of land mortgage banks".

The arrangement suggested by Mr. V. Ramadas Pantulu will appeal to many people interested in agricultural credit. But it is doubtful whether the difficulties involved in advancing long-term loans to the agriculturists have been fully considered. It may be risky on the part of the insurance company to

advance long-term loans to agriculturists in remote villages on the security of land. It will be extremely difficult to collect the annual instalments. It is doubtful whether the agents of the insurance companies can undertake this work. It is true that land-mortgage banks are lending long-term loans precisely to this class of persons. But then land-mortgage banks specialise in this kind of business and what is possible in their case may not be possible in the case of insurance companies which will lend long-term loans to agriculturists as a side-line. But these difficulties are not insuperable.

The question is whether insurance companies should be allowed to compete with land-mortgage banks. Insurance companies cannot supplant land-mortgage banks. Land-mortgage banks are indispensable in a country where the majority of the people are engaged in agriculture and where there is such a great demand for long-term credit. If insurance companies lend long-term loans along with land-mortgage banks there may be unnecessary duplication. If there are not enough land-mortgage banks in India the obvious remedy is to increase the number of land-mortgage banks. Mr. V. Ramadas Pantulu has shown that insurance companies can provide long-term

loans at lower rates of interest than land-mortgage banks. Fortunately most of our land-mortgage banks are co-operative institutions; the difference between their borrowing and lending rates need not be very great. Today, they derive their working capital mainly from debentures and long-dated deposits and they have to pay fairly high rates of interest to the debenture-holders and the persons from whom they receive deposits. If they are provided with sufficient long-term funds at low rates of interest they will be in a position to provide long-term loans at rates of interest which will be greatly below the rates of interest charged by them at present. Insurance companies can very well lend a part of their funds to the land-mortgage banks. They need not lend directly to the land-mortgage banks; they can take up a large proportion of the debentures floated by the Central Land-Mortgage Bank, or they can lend directly to those banks. The insurance companies will be satisfied with a low rate of interest. The money which they invest in these debentures and the money which they lend to the Provincial Land-Mortgage Banks can ultimately be lent on long term by the primary land-mortgage banks. The

primary land-mortgage banks will be in a position to charge a low rate of interest, if the insurance companies provide the necessary long-term funds through the Provincial Land-Mortgage Banks.

The insurance companies can easily invest a large part of their funds in debentures issued by Provincial Land-Mortgage Banks. These debentures are guaranteed as to principal and interest by the Government of the province concerned. They can in this way provide long-term loans for agriculturists. As a matter of fact, many insurance companies have invested a portion of their funds in these debentures.¹

4

In one particular case insurance companies can themselves lend long-term loans. In the cities and the bigger towns, insurance companies can lend long-term loans on the security of immovable property.² In every case the loan should be granted after an inquiry. But the officers of the companies can conduct the necessary inquiries. They can similarly collect the annual instalments due from the borrowers. Such long-term loans

1. Mr V. Ramadas Pantulu, *Ibid.*

2. An insurance company can lend long-term loans in the city in which it has its Head Office and in cities and towns in which it has Branch Offices.

should be provided by the Head Office or by the Head Office through the Branches. Some insurance companies invest a part of their funds in mortgages on property. But the majority do not seem to favour this mode of investment.¹

Insurance companies need not compete with house-building societies. As far as possible, insurance companies should not interfere with the work of house-building societies. They should provide long-term loans on the security of house-sites or houses which have been already constructed.

Insurance companies can conveniently combine insurance with lending. They can provide long-term loans for their own policy-holders living in cities. This is different from the arrangement discussed in section 2 of this chapter. We have seen that it is possible to link up the operation of land-mortgage banks with the operations of insurance companies, but in the case we are now considering the same institution does both kinds of business. An arrangement of this kind has been adopted by certain insurance companies in India. For instance, the Western India Life Insurance Co., Ltd., lends long-term loans

1. See the summary of balance sheets of Indian insurers contained in the Indian Insurance Year Book for 1945, pp. 120-151.

to its policy-holders in special cases.¹ Under Rule 3 of the House Purchase Scheme of this Company loans may be advanced to individual policy-holders partly on the security of their policies and partly on the security of residential buildings. Loans can be lent for a maximum period of 20 years.²

The investment of life insurance funds is a matter which is receiving increasing attention. It is something which concerns both the insurance and the insuring public. Of late the rates of interest have been progressively declining.³ This will result in high premiums and reduced bonuses to policy-holders.⁴ The insurance companies must think of new ways of investing their funds. The rate of interest on long-term loans lent to individuals and firms is likely to be higher than the present long-term rates of investment. Insurance companies can earn higher rates of interest if they lend their funds on long term. The various ways in which they can provide long-term loans have been already discussed.

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1. I have selected this example at random.
 2. See Rule 7 of the House Purchase Scheme of the Company.
 3. See Para 31 of the Report by the Superintendent of Insurance contained in the Indian Insurance Year Book for 1945.
 4. See paras 35 and 36 of the Report.

CHAPTER IX.

LONG-TERM CREDIT AND CO-OPERATION.

1

It is necessary to consider the place of co-operation in our system of long-term credit. In this country, at any rate, credit co-operation is regarded as the most important form of co-operation. It has made enormous progress, whatever the success achieved by credit co-operative societies. But our co-operative credit societies supply mostly short-term credit. Short-term credit can very well be supplied by banks conducted on a co-operative basis. If credit is to be cheap and plentiful there must be a sufficient number of co-operative credit institutions. Short-term credit should be mostly supplied by the co-operative societies. The private money-lender who now provides short-term loans at exorbitant rates of interest may be superseded by co-operative credit societies. So also may many of the commercial banks which supply short-term credit. But there will always be need for some commercial banks. These will provide big merchants, industrialists and other business men with working capital. But if co-operation makes sufficient progress, the majority of

the institutions providing short-term credit will be co-operative institutions.

What part does co-operation play in the provision of long-term credit? Long-term credit, as we have seen, is obtained from a great variety of sources, and it will continue to be obtained from the same sources. There is no place for co-operation if long-term credit is to be provided by private individuals who want to invest their savings at long term. Co-operation cannot play any part if long-term credit is to be supplied by Government, or by insurance companies. Under any system of long-term credit, a large portion of long-term loans will be obtained from these sources.

2

Co-operation may be possible in the case of institutions providing long-term credit. But it is only some of them that can be conducted on a co-operative basis. Indigenous credit institutions which dispense long-term loans are conducted on particular lines and it is not possible to change the organization of those institutions. There may be an element of co-operation in Nidhis¹ and Chit Funds², but they are not co-operative institutions in the technical sense of the term. But

1. See above, Chap. V, Sect. 4.

2. See above, Chap. V, Sect. 5.

certain other credit institutions dispensing long-term loans may be conducted on a co-operative basis. These are institutions borrowed from the West. It is extremely doubtful whether industrial banks which provide long-term credit for industries can be conducted on a co-operative basis. As we have seen, the industrial banks in a province can never be independent units.¹ They will be simply branches of the Provincial Industrial Credit Corporation. It is only the Provincial Industrial Credit Corporation that can be a co-operative organization. But this central organization can never be truly co-operative. How can a Provincial Industrial Credit Corporation which derives a very large part of its capital from debentures and which finances all sorts of industries be conducted on a co-operative basis? The Provincial Co-operative Bank is in a different position. The Central Banks in the province are members of this bank, and the whole organization can be of a co-operative character. But the various industrial banks in the province will be simply branches of the Provincial Industrial Credit Corporation.²

But institutions supplying long-term credit to agriculturists are in a different

1. See above, Chap. VI, Sect. 4.

2. Ibid.

position. They can be conducted on a co-operative basis. At least in theory they can be conducted on the same principles as ordinary co-operative banks providing short-term credit. There is no reason why a land-mortgage bank dispensing long-term loans to agriculturists should not be of a co-operative character. A co-operative land-mortgage bank would derive its working capital from shares purchased by its members and from money deposited with the bank (by members and outsiders) for fairly long periods. It is found, however, that land-mortgage banks cannot be run on exactly these lines. It is clear that if a land-mortgage bank is to be a truly co-operative concern its operations must be restricted to a small group of villages. This ensures that the members know one another. It will also facilitate the identification and valuation of the land to be mortgaged by the borrower. The question is, can the necessary long-term funds be supplied by persons living within this small area? A part of the working capital is obtained from share-capital. But in the case of a primary land-mortgage bank only a small part of the funds required can be obtained from this source. A primary land-mortgage bank cannot

hope to get much money by way of deposits. As we have already seen (Chapter VI, Section 2) primary land mortgage banks do not ordinarily receive deposits. The Central Banking Enquiry Committee were not in favour of permitting such banks to receive deposits.¹ But they have to lend large sums of money. We have already noticed that agriculturists who go in for long-term loans generally borrow pretty large sums on the security of their immovable property. Hence it is that co-operative land-mortgage banks derive most of their working capital from the Provincial Land-Mortgage Bank. But, it will be said, the primary co-operative credit societies which provide short-term credit derive a part of their working capital from Central Co-operative Banks which, in their turn, rely on the Provincial Co-operative Bank for a part of their working capital. But the Provincial Co-operative Bank is a fully co-operative institution. It relies on its share-capital subscribed by the members and on deposits from members and from outsiders.² But the Provincial Co-operative Land-Mortgage Bank relies mostly on debentures.

1. See the Central Banking Enquiry Committee Report, para 224.

2. I know that some Provincial Co-operative Banks borrow loans from the Government. But these are exceptional cases.

The Bombay Provincial Co-operative Land-Mortgage Bank was started in 1935. In 1941 the paid-up share capital of the Bank stood at Rs. 471900/-. By then it had floated two series of debentures. The total amount of debentures in circulation at the end of June, 1941, was Rs. 30 lakhs.¹ The same is true of the Madras Central Land-Mortgage Bank. The bank's principal way of borrowing is by way of debentures.² The debentures in circulation at the close of the year 1943-44 amounted to Rs. 2,85,58,700/-. But the paid-up share-capital was only Rs. 10,81,600/-.³ The facts speak for themselves. The primary land-mortgage banks derive a very large part of their working capital from the Provincial Land-Mortgage Bank, which relies mostly on debentures. It is true that the primary land-mortgage banks often subscribe for these debentures. But they buy only a small proportion of the debentures issued by the Provincial Land-Mortgage Bank. As Mr. V. Ramadas Pantulu says,⁴ in our co-operative land-mortgage banks co-operation is not a marked and decisive element.

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1. See the Annual Report of the Bank for the year 1941.
 2. See the Annual Report of the Madras Central Land Mortgage Bank, p. 2.
 3. Ibid, pp. 2-3.
 4. See 'Economic Problems of Modern India', Vol. I (1939), Chap. X, pp. 192-198.

What about co-operative house-building societies? They are in the same position as co-operative land-mortgage banks. True, they do not derive any part of their working capital from an apex bank. That does not mean that they are self-sufficient. In some cases they were being financed by the Government.¹ They cannot hope to be self-sufficient. Nor do they derive any part of their working capital from an apex bank which is a fully co-operative institution.

From the nature of the case co-operative banks and co-operative house-building societies cannot be fully co-operative institutions. They are co-operative institutions in a technical sense and not in any real sense. That is to say, they cannot be co-operative institutions in the sense in which ordinary co-operative societies providing short-term credit are. Thus co-operation cannot play a large part in providing long-term credit either now or at any time in the future.

This does not mean that land-mortgage banks and house-building societies should not be organized on a co-operative basis. Technically at least they should be co-operative institutions. The expenses will be less if they are conducted on a co-operative

1. See above, Chap. VI, Sect. 8.

basis, for however small the element of co-operation in such institutions most of the office-bearers will be honorary workers. And they will not be run for profit. So there will not be much difference between the borrowing and lending rates.

It may here be noted that most land-mortgage banks in this country are technically co-operative institutions. The number of shares owned by the members is limited; the rule of 'one man, one vote' irrespective of the share-capital subscribed is generally adopted; dividends are restricted to a low figure.¹ This is as it should be.

CHAPTER X.

THE ESSENTIALS OF A SOUND SYSTEM OF LONG-TERM CREDIT.

1

It may be asked whether there is such a thing as a *system* of long-term credit. In any country long-term credit may be supplied by different agencies which are unrelated to one another. Long-term credit may be provided by whatever means are found suitable. These may not form a system. Such is the case at present, at least in our

1. The Central Banking Enquiry Committee Report, para. 200.

LONG-TERM CREDIT

country. But this need not always be the case. We can think of a unified and well-organized system of long-term credit. Considering the importance of long-term credit, it is most necessary to have such a system of long-term credit. If long-term credit is to be provided according to a system, it is worth while to have as sound and scientific a system as possible.

Whatever system of long-term credit may be adopted, institutions which exist primarily for supplying short-term credit should not dispense long-term loans. These should be distinct from credit institutions providing long-term credit. Long-term credit should be supplied from a separate source, or sources. This point has been fully discussed in Chapter I, Section 5, and need not be repeated here.

But a different question has to be considered in this connection. Should institutions which exist for the purpose of supplying long-term credit provide short-term credit also? Theoretically they can provide both forms of credit. They rely on their share-capital, long-dated deposits, and debentures, especially

debentures.¹ Out of the funds which have been raised by these means they can provide short and long-term loans. An industrial credit corporation, for instance, can provide both temporary and long-period finance for industrial businesses. Thus the Finance Corporation for Industry Limited, an industrial bank recently started in England, provides both short-and long-term credit for industries.² But such an arrangement is not to be recommended. An industrial concern should not rely on an industrial bank for its working capital. This it should borrow from ordinary commercial banks. Fortunately in our country there are big and efficient commercial banks, with a network of branches. These can easily provide short-term credit for industrial purposes. The provision of long-term credit is a much greater problem than the provision of short-term credit. An industrial credit corporation which is best fitted to provide long-term credit should concentrate on that form of credit; it should not dissipate its resources by providing short-term credit as well. Any commercial bank can provide short-term credit for any purpose whatsoever.

1. See above, Chap. VI, Sect. 1.

2. 'The Times of India', 25th January 1945.

2

Our brief survey of the sources of long-term credit has shown us that long-term credit can be supplied and is being supplied by a great number of agencies. It is supplied by private individuals as well as by institutions; and there are a great variety of institutions. But an institution which provides long-term loans cannot provide such loans for all purposes. A land-mortgage bank, for instance, can supply long-term loans for making agricultural improvements or for liquidating prior debt. But it cannot provide long-term credit for constructing houses. Such loans can be provided only by house-building societies or by some other agencies. There is the greatest need for co-ordination. Every credit institution dispensing long-term loans should provide such loans for certain definite purposes. This will lead to a harmonious development of our credit system. Moreover, our sources of long-term credit cannot be fully utilized if there is duplication and overlapping. But the need for co-ordination has not been fully realised. The result is unnecessary duplication in some cases. It will be convenient if I refer once again to each source of long-

term credit and the way or ways in which it should be utilized.

Land-mortgage Banks. These will supply long-term loans to agriculturists for agricultural improvements, for liquidation of prior debt and for purchasing land. But many are the uses of long-term credit and an agriculturist may borrow a long-term loan for purposes other than those mentioned above. But in every case it must be shown that a long-term loan is absolutely necessary. Land-mortgage banks should lend long-term loans to agriculturists only and they should, of course, lend on the security of land.

House-building Societies. These will function only in towns and cities. They should provide long-term loans for constructing houses and for making repairs to existing houses. They should make it their policy to encourage the building of new houses. It is not desirable for house-building societies to make long-term advances on the security of house-sites or houses for any other purpose.¹

Nidhis and Funds. These should be organized in urban areas. Their main business will be to provide long-term loans for their members. The loans may be provided on the

1. See above, Chap. VI, Sect. 3.

security of houses already constructed. This will prevent competition between these institutions and co-operative house-building societies. If a man who has no cash wants to build a house for himself he will approach a house-building society, which will lend him a long-term loan on the security of the site on which the house is to be constructed. Of course, the house, when constructed, will form a part of the security. If, on the other hand, he wants to purchase a house already constructed he will join a Nidhi or Fund and obtain from it a long-term loan.¹

Insurance Companies: These will not ordinarily provide long-term loans for private individuals. They can, however, provide Provincial Land-Mortgage Banks with long-term credit either by lending directly to them or by taking up the debentures issued by them. Insurance companies may, if they so desire, lend long-term loans to their policy-holders in the cities.² The policy-holders in the cities may borrow long-term loans from their insurance companies on the security of their houses, in case they are not members of any Nidhi or Fund. Of course, if they want long-term

1. See above, Chap. V, Sect. 4.

2. See above, Chap. VIII, Sect. 4.

loans for constructing houses, they will approach house-building societies.

Industrial Credit Corporations: These institutions will provide long-term loans for long-established industries. The industries will be either small-scale industries or cottage industries.

The Government: It will provide long-term loans for nascent industries and for industries about to be started.¹ As a credit agency the Government will also provide long-term credit for agriculturists who do not own land; but it will provide long-term loans only for purchasing agricultural machinery.² Ordinarily the Government should not lend long-term loans to agriculturists who own land. But it may lend long-term loans to such agriculturists for the liquidation of prior debt in certain exceptional cases.³

Private Individuals who lend on longterm: These will lend long-term loans to all classes of people who can offer proper security, and for all purposes. Ordinarily, a man who is in need of a long-term loan will borrow it from the appropriate credit institution, or from the Government. If, however, he finds that he

1. See above, Chap. VIII, Sect. 2.

2. See above, Chap. VIII, Sect. 3.

3. See above, Chap. VI, Sect. 6.

can obtain a long-term loan very easily and at a specially low rate of interest from some private individual he knows, he ought to borrow from him.¹

Chit Funds: If a person who has initiative and organizing ability wants a long-term loan, he may start a Chit Fund. It may be the best way of obtaining a long-term loan, provided all goes well.² I do not suggest that every man in that position should promote a Chit Fund. I am merely trying to show when and by whom this particular source of long-term credit can be utilized.

3

Just as there is need for co-ordination there is need for co-operation. At present the various agencies providing long-term credit are not related to one another. But there is very great need for co-operation in several cases.

Today most long-term loans are provided by private individuals. This system will survive, in spite of its defects. The system is defective mainly because there is no provision for repayment by instalments.³ But this

1. See above, Chap. V, Sect. 2.

2. See above, Chap. V, Sect. 5.

3. See above, Chap. V, Sect. 2.

defect can be removed by linking it up with that system of long-term credit under which long-term credit is supplied by land-mortgage banks. A man who borrows a long-term loan from a private individual can arrange to deposit with the nearest land-mortgage bank a part of the principal every year. When the loan falls due he will have deposited enough money to repay the loan. This will greatly help the borrower. Since the deposits are long-dated deposits the bank can make long-term advances out of these. This arrangement will thus benefit both the borrower and the bank. But we do not find this arrangement anywhere at present. The land-mortgage banks in the country may be expected to take the initiative in this matter. Fortunately most of them are of a co-operative character. As co-operative institutions they are interested in the welfare of the agriculturists. A land-mortgage bank should try to induce the agricultural debtors who have borrowed long-term loans from individuals to deposit with it every year a part of the principal. Some propaganda will be necessary in the beginning. It is not too much to expect our co-operative land-mortgage banks to carry on such propaganda. Here is one example of the co-operation mentioned above.

Another example of such co-operation may be given. As we have seen, there is such a thing as dismortgaging land-mortgage credit by insurance. There are two methods of doing this.¹ Whatever the methods adopted, the bank which makes long-term advances on the security of land must co-operate with the insurance firm with which the borrowers have insured. We have already seen the need for such co-operation.² But such co-operation is possible only when the insurance firm is conducted on a co-operative basis.³ The co-operative insurance society can, further, assist the Provincial Land-Mortgage Bank by investing its surplus funds in the bank. It can either make long-term advances to the bank or invest a part of its funds in debentures floated by the bank.⁴ Here we have a system of long-term credit whose different parts are related to one another. It is thus possible to achieve a large measure of co-operation between the different parts of our system of long-term credit.

4

Whatever the agencies providing long-term

1. See above, Chap. VIII, Sect. 2.

2. Ibid.

3. Ibid.

4. See above, Chap. VIII, Sect. 3.

credit, long-term credit has to be rationed. (I am not using the word "ration" in the technical sense). The supply of long-term credit is limited; it is necessarily limited. The supply of short-term credit, on the other hand, is not necessarily limited. We can increase the supply of short-term credit by increasing the volume of savings. A man who has saved some money may be assumed to be willing to lend it for short periods. (There are, of course, people who prefer to hoard their money, but hoarding is not at all common at the present time). But a man who has saved some money may not be willing to invest it on long term. It is only particular savers in particular cases who can be expected to lend on long term. The supply of long-term credit is thus uncertain. And the supply will be considerably curtailed in times of uncertainty. But the supply of short-term credit will remain the same; it may even increase. Hence there is always need for rationing long-term credit.

Take, for instance, the case of the man whose estate is mortgaged to the hilt. He may like to redeem his estate by borrowing a fresh loan (which has to be a long-term loan) on the security of his estate. But in this case a long-term loan will be of doubtful utility. It

is extremely doubtful whether the man will be able to clear himself of debt. A better course would be to sell the estate, or a part of it. If long-term credit is to be rationed, this man will not get a long-term loan. At present even people who are engaged in production find it difficult to obtain long-term loans. But under rationing it will be easier for such people to borrow long-term loans than it will be for those who want to borrow loans for unproductive purposes. I do not suggest that long-term loans should not be borrowed for unproductive purposes. As we saw in Chapter II, many are the legitimate uses of long-term credit. But the needs of those who want to start industries or to make improvements to agricultural land must be considered first.

How can we ration long-term credit when long-term credit is supplied mostly by private individuals? A man who lends a long-term loan considers only the security for the loan. This is natural. Long-term credit can be rationed only when it is supplied by co-operative institutions or by the Government. These institutions are not run for profit. A time will come when long-term credit will be

supplied mostly by co-operative land-mortgage banks and by industrial credit corporations. The latter will necessarily lend long-term loans for productive purposes. The total volume of capital which is to be lent on long term can be apportioned between land-mortgage banks and industrial credit corporations. The Government will be in the best position to do this; it will regulate the issue of debentures by the Provincial Land-Mortgage Bank and the Industrial Credit Corporation. These institutions will rely mostly on debentures;¹ and the Government will have to guarantee both principal and interest in the case of debentures issued by these institutions. In regulating the issue of debentures by the Provincial Land-Mortgage Bank and the Industrial Credit Corporation the Government will consider the needs of agriculture and industry at the time. There will still be co-operative house-building societies, and these will lend long-term loans which will not be used in production. But it is possible to regulate the volume of capital which will be lent by house-building societies. As we have seen,² in future co-operative house-building societies will derive a large part of their working capital from the Provincial

1. See above, Chap. VI, Sect. 1.

2. See above, Chap. VI, Sect. 3.

Co-operative Land-Mortgage Bank. Insurance companies too may provide long-term credit. But they are provided through the Provincial Land-Mortgage Banks.¹ Thus under a unified system of long-term credit it is possible to ration long-term credit.

Rationing of long-term credit, however, does not imply any limit to the amount of money that can be borrowed by an individual or corporation. There should not be any limit to the amount of money that can be borrowed for long periods. As we saw in Chapter I, Section 3, the success of a long-term loan depends on the amount borrowed. If a man borrows a long-term loan, he must take care to borrow an amount which will be sufficient to discharge all his liabilities.

CHAPTER XI

SOME CONCLUSIONS

1

Some conclusions emerge from our discussion of the various aspects of long-term credit. These may be briefly stated.

Long-term credit possesses many distinct characteristics which make it so different from

1. See above, Chap. VIII, Sect.

short-term credit. These have been discussed in Chapter I. The casual observer rarely notices these characteristics. But these characteristics are of the greatest significance. The casual observer, for instance, does not care to inquire what particular kind of security can be accepted in the case of a long-term loan. He knows that a long-term loan is generally a mortgage loan, but he does not know that it must necessarily be a mortgage loan. He does not know that from the very nature of the case a long-term loan cannot be lent on personal security or on the security of movable property. The borrower himself would in most cases refuse to borrow a long-term loan on the security of his movable property.¹

It is not only its distinct characteristics that differentiate long-term credit from short-term credit. It has many distinct uses. These have been enumerated in Chapter II. This fact also is of great significance. A short-term loan can never serve the purpose of a long-term loan. It would be folly to borrow a short-term loan when a long-term loan is required.²

There are many problems which are peculiar to long-term credit. These have been

1. See above, Chap. I, Sect. 4.

2. See above, Chap. II, Sect. 7.

fully discussed in Chapter IV. None of these problems arise in the case of short-term credit. The rate of interest on long-term loans is determined by factors which are different from those which determine the rate of interest on short-term loans.¹

These various differences between long-term and short-term credit are not fully noticed by people who have not made a special study of the subject. They think that there is no hard-and-fast difference between long-term and short-term credit. According to them the difference between these two forms of credit is one of degree. But it is a difference of kind. This is most remarkable. Loans can be lent for different periods. If the period is increased beyond a certain point we have a distinct form of credit which is so different from short - or medium - term credit, a form of credit which gives rise to many problems and complications. In no other economic matter is the time element of such great importance.

2

Our investigations have revealed certain significant facts relating to the provision of long-term credit. These are among the most

1. See above, Chap. III, Sect 2.

important facts concerning long-term credit. It is not possible to build up a sound and scientific system of long-term credit without a knowledge of these facts.

Although any loan made for more than 10 years can be called a long-term loan, the period of a long-term loan is at least 20 years. It is longer in many cases. A person in a city who borrows a long-term loan for buying a house can hardly be expected to repay it within 25 years. A tenant-cultivator who borrows a long-term loan for purchasing the farm he has been cultivating as a tenant cannot be expected to repay the loan within 50 years.¹ These are long periods. What individual will be willing to lend a loan for such long periods? Considering the average duration of life in this world, it is foolish to expect private individuals to lend for such long periods. No individual, I believe, is prepared to lend for more than 10 or 12 years in the first instance.² But, it will be said, under a fully developed system of long-term credit, long-term credit will be supplied mostly by institutions which can lend for sufficiently long periods. True. In future we will have all sorts of credit institutions supplying long-term loans. But a

1. See above, Chap. VII, Sect. 7.

2. See above, Chap. V, Sect. 2,

moment's reflection will show that the loans must ultimately be provided by individuals. The institutions provide long-term loans out of long-term funds supplied by individuals. Credit institutions can indeed provide long-term loans out of share-capital. But, as we have seen,¹ they cannot rely wholly on share-capital. A very large part of the working capital is lent by private individuals. We have seen that there is another difficulty in providing long-term loans. It is only fairly large sums that can be lent for long periods. Many individuals may be prepared to lend for long periods, but the sums which they can afford to lend for long periods are not large enough and consequently will not be borrowed for long periods.²

These two difficulties can be solved at one stroke. Credit institutions have to raise long-term funds by means of debentures. Of course, debentures are long-dated loans borrowed from private individuals. But the difficulties noticed above do not exist in the case of these long-term loans. These debentures may be redeemable after 20 or 25 years; they may be redeemable after 50 years. But still they will be bought by the investing public. (We assume

1. See above, Chap. VI, Sect. 1.

2. See above, Chap. I, Sect. 6 and Chap. VI, Sect. 2.

that the credit institutions issuing the debentures are financially very sound). They bear a fixed rate of interest and the risk is negligible. Also, they are readily marketable. They can be bought even by those who are not prepared to lend for long periods, for they can be converted into cash without much difficulty.

The implications of this important principle must be fully realised. Under any scientific system of long-term credit, long-term credit will be supplied by credit institutions like land-mortgage banks. These must make long-term advances out of long-term funds provided by the debenture-holders. Under this system it will be possible to collect small sums of money and lend them for very long periods. The idea underlying debentures must be fully exploited. Only in a few isolated cases long-term credit will be supplied by private individuals.

I have said that the long-term loans lent by institutions are ultimately obtained from private individuals. But this is true only of loans supplied by credit institutions. An insurance company is in a position to provide long-term loans, although it does not borrow any long-term loans from private individuals, either directly or indirectly.¹ It is true that

1. See above, Chap. VIII, Sect. 3.

the money out of which long-term loans can be provided is supplied by policy-holders, who are private individuals. But the money is not *lent* to the insurance company. The money is paid as premiums. No individual is probably prepared to lend money to an insurance company for 20 or 25 years. So insurance companies are the only institutions which can provide long-term loans without borrowing such loans from private individuals. They can lend large sums of money for long periods. The difficulties noted above do not exist in the case of long-term loans supplied by insurance companies.

But insurance companies are not generally in a position to lend to private individuals.¹ They can, however, take up the debentures issued by credit institutions. This is one way of investing their funds. But insurance companies ought to leave such debentures for private individuals who have some money to invest. If long-term loans are to be obtained from private individuals they are to be obtained through debentures. As we have seen, this is the best arrangement we can think of. In the majority of cases long-term loans are to be ultimately provided by private individuals.

1. See above, Chap. VIII, Sections 3 and 4.

Debentures issued by credit institutions should be bought by private individuals and insurance companies ought not compete with them. Insurance companies can afford to lend loans for long periods; there is no reason why they should provide long-term loans indirectly by buying debentures issued by credit institutions. It is true that insurance companies cannot lend long-term loans to private individuals. But they can very well make long-term advances to the Central Land-Mortgage Banks. The money which will be lent to these institutions by insurance companies will ultimately be lent to agriculturists and others who are in need of long-term loans. Land-mortgage banks always lend on good security and there is no risk in lending long-term loans to such institutions. It is to be hoped that insurance companies will provide land-mortgage banks with long-term loans whenever they are in need of such loans. If a Provincial Land-Mortgage Bank can raise all the necessary long-term capital by means of debentures, insurance companies can take up a portion of the debentures. In that case no insurance company need directly lend to the bank.

3

Among the facts concerning long-term

credit there is one fact which stands out very clearly. A long-term loan must in a large number of cases be repaid by instalments. Where it is not strictly necessary to repay a long-term loan by instalments, it is extremely desirable to adopt this method of repayment. We have not yet fully realised the need for repaying long-term loans by instalments. Repayment by instalments is regarded merely as an advantage enjoyed by some borrowers of long-term loans. It is not merely an advantage; it is a necessity. Repayment by instalments will be insisted upon under a sound system of long-term credit. The repayment of long-term loans by instalments has at least six advantages:— (1) A long-term loan is generally repaid out of annual savings; so the borrower must, in his own interest, pay to the creditor every year a part of the principal with the money he has saved. This is the best way of repaying a long-term loan.¹ (2) Repayment by instalments is an advantage to the lender when the security offered is not sufficient, or is not of the proper kind. A man who lends a long-term loan to a producer on the security of machinery finds that it is safer to recover the loan by instalments. In all such cases the

1. See above, Chap. I, Sections 2 and 3.

lender's policy should be to recover from the borrower as much as possible during the currency of the loan.¹ (3) Repayment by instalments is the only solution for the problem caused by changes in the level of prices. It minimizes the risk due to the changes in the level of prices. It is thus an advantage both to the lender and borrower of a long-term loan.² (4) If a long-term loan is lent on the security of a life-policy on the life of the borrower the loan will have to be repaid by instalments. The risk will be less if the loan is repaid by instalments. Every year the surrender value of the policy will increase as the premiums are paid, and the amount due from the debtor will decrease as the instalments are paid.³ (5) A mortgage-loan for a long period has to be repaid by instalments if any insurance company is to guarantee payment of the loan outstanding at the time of the death of the borrower. As the instalments are paid the risk involved in guaranteeing the payment of the loan becomes less and less. It is only in such a case that an insurance company will undertake to guarantee payment of the loan outstanding on the death of the borrower.⁴

1. See above, Chap. VI, Sect. 4.

2. See above, Chap. IV, Sect. 4.

3. See above, Chap. IV, Sect. 1.

4. See above, Chap. VIII, Sect. 2.

(6) A credit institution lending long-term loans will insist on the loans being repaid by instalments. A part of the money borrowed will be repaid every year and out of this a few more long-term loans can be provided.¹ We can thus economize in the use of long-term credit.

4

We cannot have a ready-made system of long-term credit. In this long-term credit differs from short-term credit. We can have a ready-made system of short-term credit, since we know the various sources of short-term credit and the nature and working of the institutions which provide this form of credit. But all the sources of long-term credit are not fully known; nor are the known sources fully utilized. We have, therefore, to build up a system of long-term credit in this country. In order to do this we have to investigate all the sources of long-term credit. There is thus great need for investigation and research. There is also need for experiments. Take Chit Funds. As credit institutions they may not be suitable for all people in need of long-term loans and in all cases. What particular demands for long-term credit can be

1. See above, Chap. VI, Sect. 1.

met by Chit Funds? What are the various defects of this particular system? How to remove these defects? We cannot answer these questions off-hand. We see the need for investigations and large-scale experiments. We have to experiment with various forms and devices. What has been said of Chit Funds is true of many other institutions providing long-term credit.

But who is to carry on these investigations and conduct these experiments? Obviously this work cannot be undertaken by private individuals. The Provincial Governments must take up the work. It is to be hoped that every Provincial Government will have a Board of Economic Enquiry which will examine economic problems and conduct investigations.¹ The Board can, after many investigations and experiments, devise a suitable system of long-term credit for the Province. Our system of long-term credit must not be based on the abstract; it must be based on experience.

1. There is such a Board in the Punjab. The Punjab Board of Economic Enquiry is a Semi-Government Body. It is conducting inquiries and is collecting useful data— See Pramathanatha Banerjee, "A Study of Indian Economics", (1940), p. 5.

APPENDIX I

(See pp. 64-69)

In trying to trace the movements in the long-term rates of interest between 1919 and 1944 I examined 32 cases. The number may appear to be very small, but it is extremely difficult to collect information of this kind. In each case I questioned the parties to the mortgage deed, and in most of the cases I examined the mortgage deed. I found that in almost all cases the loan began as a medium-term loan. But it would be repaid after a long period. Of the 10 loans borrowed before 1931 not one was borrowed for more than 10 years; but all the loans turned out to be long-term loans. I began the investigations in 1934 and I could select only loans which had ended as long-term loans. Most of the loans which were borrowed after 1931 began as medium-term loans; only one loan was borrowed for 12 years when it was first borrowed. Of these 8 were repaid after 1942, that is after more than 10

years (they had been borrowed before 1934). One has not been repaid even to this day. I have lost trace of the others. All the loans borrowed after 1942 are medium-term loans. But I am sure that most of them will turn out to be long-term loans. The lenders of medium loans know that the money will not be repaid for a long time and are prepared for this. In fact most of them welcome this. The rates of interest which they charge may be regarded as long-term rates of interest. I give below the rate of interest charged in the case of each of the loans noticed by me. The actual period of the loan can be given only in the case of the loans borrowed before 1931.

Long-term Rates of Interest before 1931.

Loan	Actual period (in years) of the loan	Rate of interest
A	12	5 %
B	11	5 %
C	19	5½%
D	11	5 %
E	13	5½%
F	15	5 %
G	14	5 %
H	12	5 %
I	11	5½%
J	16	5 %

Long-term Rates of Interest between 1931 & 1942.

Loan	Rate of interest
K	5 %
L	5½%
M	6 %
N	6 %
O	5½%
P	5 %
Q	5½%
R	5 %
S	6 %
T	5½%
U	6 %
V	6 %

Long-term Rates of Interest after 1942.

Loan	Rate of interest
W	4½%
X	4½%
Y	4 %
Z	3 %
A1	4 %
B1	3 %
C1	4 %
D1	4 %
E1	4 %
F1	5 %

We need not find out the average long-term rate of interest during these various periods;

averages in this case are somewhat misleading. But we can very clearly see the trends. Before 1931, in 7 cases out of 10 the long-term rate of interest was 5 per cent. Between 1931 and 1942 it was 5 per cent in only 3 cases out of 12; in 5 cases it was $5\frac{1}{2}$ per cent, and in 4 cases it was as high as 6 per cent. After 1942, in 2 cases out of 10 the long-term rate of interest was as low as 3 per cent; in only one case noted by me was it more than $4\frac{1}{2}$ per cent. I am well aware that these data are woefully inadequate. These data have been collected in Udipi Taluk. With these data it is not possible to trace the movements in long-term rates of interest even in that Taluk. But I have met many lenders and borrowers in different parts of South India, and from these I could learn that the long-term rates of interest rose after 1931 and that they fell after 1942. The figures cited above illustrate, rather than prove what I have said on this subject.

APPENDIX II

(See pp. 120-121)

At present long-term loans are supplied mostly by private individuals. Loans lent by private individuals are mortgage loans. If one

examines the mortgage deeds which have been registered in a Registry Office, one gets a wrong impression. Most of the loans figure as medium-term loans. From this we should not conclude that private individuals do not lend long-term loans. Such loans are obtained mostly from private individuals. An agriculturist who needs a long-term loan will borrow a medium-term loan in the first instance. He rarely repays the loan when it falls due. The loan is not usually renewed. As we have seen (see p. 126), the period of limitation which governs a suit to recover the money due on a mortgage is 12 years. Sometimes the loan is renewed; in some cases it may be renewed more than once. I give below a list of long-term loans. In each case, the period for which the loan was originally borrowed and the actual period of the loan are given. This will give some idea of the nature of these transactions. I have included loans which were borrowed in the 19th century. Some of the loans mentioned below have been referred to in the previous appendix but in a different connection. Here they are referred to as A, B, C, etc for the sake of convenience. But Loan A in this appendix is not necessarily Loan A in the previous appendix.

Loan	Period (in years) for which the loan was originally borrowed	Actual period (in years) of the loan
A	10	32
B	5	5
C	8	21
D	12	12
E	4	15
F	5	9
G	10	14
H	5	7
I	5	8
J	10	22
K	12	23
L	4	11

I have selected these examples at random. It will be observed that most medium-term loans are in effect long-term loans.

APPENDIX III

(See pp. 144-148)

I give below certain figures relating to a Chit Fund which has run its course. This will give some idea of the Chit Fund as a credit institution.

The Chit Fund was started in 1922, and had 11 members, including the President. It

ran for 10 years. It was in effect a Chit Fund for Rs. 1000/-. Each year a certain sum of money was raised, every member contributing an equal amount, and the money was made over to one member of the Fund. The following table gives the figures for each successive year.

Year	Total amount of money subscribed.	Amount subscribed by each member	Amount actually received by member who got the Fund.
1922	Rs. 1000 0 0	Rs. 90 14 7	Rs. 909 1 5
1923	Rs. 639 0 0	Rs. 58 1 5	Rs. 580 14 7
1924	Rs. 679 0 0	Rs. 61 11 8	Rs. 617 4 4
1925	Rs. 700 0 0	Rs. 63 10 2	Rs. 636 5 10
1926	Rs. 721 0 0	Rs. 65 8 9	Rs. 655 7 3
1927	Rs. 752 0 0	Rs. 68 5 10	Rs. 683 10 2
1928	Rs. 796 0 0	Rs. 72 5 10	Rs. 723 10 2
1929	Rs. 850 0 0	Rs. 77 4 4	Rs. 772 11 8
1930	Rs. 920 0 0	Rs. 83 10 2	Rs. 836 5 10
1931	Rs. 948 0 0	Rs. 86 2 11	Rs. 861 13 1
1932	Rs. 1000 0 0	Rs. 90 14 7	Rs. 909 1 5

In the first year there was no auction, and hence no bidding. In that year the President got the Fund, without paying any discount. He got Rs. 1000/- *minus* his contribution for that year. He thus got Rs. 909-1-5. In 1923 the Fund was put up to auction. As there was keen competition, the successful bidder

had to offer a very large discount. He got Rs. 639/- *minus* his contribution for that year. So he got only Rs. 580—14—7. As a member could get the Fund only once, every year the number of bidders decreased. Smaller discounts were offered as the number of bidders decreased. Hence the total amount of money that had to be raised by the members increased, as the figures in column 2 of the table show. In the last year there was no bidding at all. Hence the member who got the Fund received Rs. 1000/- *minus* his contribution. He received the same amount as the President in the first year.

It is clear from the figures given in the table that the President got the greatest benefit from the Chit Fund. In 1922 he received Rs. 909—1—5. Every year, for 10 years, he had to subscribe a certain sum of money. In 1923 he subscribed Rs. 58—1—5, in 1924 Rs. 61—11—8, and so on. He thus obtained a loan of Rs. 909—1—5, which he repaid in slightly more than 10 years. He repaid the loans by instalments. Judging from the amounts subscribed by him in 1923 and the following years, the rate of interest was very low.

The member who got the Fund in the last year also received much benefit from the Chit Fund. The Chit Fund provided a good invest-

ment for the various sums of money he subscribed between 1922 and 1931.

How the other members fared can similarly be seen from the table. The member who got the Fund in the second year got only Rs. 580—14—7, after his subscription for that year was deducted from the bid amount, which was Rs. 639/-. He had already paid Rs. 90—14—7 in the first year. The various sums subscribed by him after he got the Fund are shown in column 3 of the table. The loan of Rs. 580-14-7 which he obtained in 1923 had to be repaid in 9 years. It was a medium-term loan. Thus only the President could obtain a long-term loan from the Chit Fund.

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