initiate important changes in policy

From the confused controversy over the bank rate, what emerges clearly is the lack of co-ordination in the. money market and its very great susceptibility to the foreign balance situation. The former also brings into relief an important source of weakness in the money market organisation as it has developed in recent years, namely, the absence of a short-term market for loans. Since a proper bill market never developed here, Treasury Bills at one time promised to fill this gap partially and served as an instrument which could be used to impart some elasticity, so that by changing the volume of Treasury Bills, the monetary authorities could influence the money market in whichever direction they wanted to, without subjecting it to severe jerks and jolts. 'The circumstances that led to swell the cash balances of the Government, put an untimely end to this experiment.

The authorities had thus to fall back upon directly operating on the long-term rates. In fact, in recent times a strange incongruity in monetary policy has been the attempt on the part of the Reserve Bank to support the structure of money rates at a few chosen points by offering to absorb only one or two selected gilt-edged securities. Thereby the structure of money rates was distorted. If support was intended, it should have been broader based for the entire structure can be either lifted up or brought down but the money market cannot stand a distortion of this structure without suffering obvious unfavourable eonsequences.

Assuming that a main inflationary factor can only arise from export surplus, in the absence of any marked investment actively within the country worth the name—indeed all evidence points to the absence of such activity in the private sector—the justification for the change in the bank rate on this particular score is difficult to find. On the contrary, expected disinflationary effects lack a basis in fact. Close observers may or may not agree with the contention of our stock exchange correspondent published elsewhere in this issue that speculative holding of stocks of commodities is today entirely absent. But if there is such speculative boarding of stocks, it is more likely to be financed out of black money, the existence of which is not denied but on which the bank rate can have no effect. Qualitative control of credit has been attempted by the Reserve Bank through directives to the scheduled banks from time to time but with what effects, it is difficult for outsiders to judge. Rationing by price, however, is least likely to be successful where speculative demand is involved, since the latter has its origin either in expected export demand or in the faltering export policy of the Government, as in the matter of grant of export quotas for oilseeds. In the absence of more convincing evidence of excessive investment in the private sector, the claim that the bank rate can possibly operate on the price level must be dismissed as unproven.

The circumstances that may force the Government to relax export restrictions are those that threaten at the moment to upset completely the. foreign exchange budget on the basis of which presumably the broad pattern of the control on foreign trade is devised.

More than the bank rate and the export policy, elections have been so timed that the same care-taker Government will have to present the next year's budget. The old Parliament will have to be recalled for the purpose. This is a grave breach of the precedent in the democratic countries for care-taker governments. But it has drawn little attention and aroused no resentment for the simple reason that the interest in the country in the forthcoming elections is itself lukewarm. Most people have taken it for granted that things will *go* on pretty much in the same way as they have done in the past, that the same set of people will run the administration, that food deficits will continue to recur with the cycle of the seasons. The pattern will never change. So why be excited?

# The Bank Rate and Scheduled Banks

IN Britain, as well as in India, the motive behind the rise in the bank rate is to force the banking system and the money market to be " in " the Bank, In Britain the bank rate was not effective. In other words the money market was always able to secure funds at rates cheaper than the bank rate because the " special buyer " was always willing to take up Treasury bills at and and a half per cent. So the banking system never had any occasion to borrow from the. Bank at the bank rate of 2 per cent.

In India, too, the bank rate was not effective for two reasons. It was not as if the market were always able to receive credits at below the bank rate. During and since the last busy season, it has been paying 3 to 3¼ pr cent for short-term advances from the Imperial Bank against approved Government securities as collateral.

The reasons why the banks prefer to borrow from the Imperial Bank, now one of their competitors, at or even above the bank rate without seeking recommendation from the Reserve. Bank are rooted deep in the past. But the fact remains that banks are reluctant to seek aid from the Reserve Bank.

There is another reason why the bank rate in India has not been effective in the recent past. Instead of seeking loans from the Reserve Bank at its traditional lending rate, banks have preferred to replenish their cash resources through liquidation of investments in gilt-edged securities. The Bank has occasionally helped the scheduled banks by purchasing securities on offer. Until Thursday, for instance, the Reserve Bank was a willing buyer of, say, Conversion Loan at Rs. 92-12. This " freezed " rate has gradually been lowered. But the banks were always sure of procuring cash through sales of securities at rates at which the Reserve Bank was a buyer.

More than the rise in the bank rate, the incidental measures announced by the authorities in Britain, as well as in India, are more significant in their repercussions on the money market. In Britain, the Bank of England will hereafter provide financial aid to the money market only on its own terms. To avoid an unduly heavy floating load on the market, the authorities have announced a series of short-term funding loans for treasury bills. This will reduce the. load by a third, though the various methods of short-terrn borrowings by the Exchequer, such as Treasury Bills and Treasury Deposit Receipts, will continue.

Will these measures force the market to be " in " the Bank? It is doubtful, although there has been a rise in related short-term money rates. But the rise in the bank rate by a half per cent, may not yet force the market to. be " in " the Bank. If there are borrowers who are willing to pay banks higher charges for accommodation, because they think that there are prospects of employing funds more, remuneratively, the banks and the money market will still be able to satisfy such demands without being forced to be " in " the Bank.

Their cash securities may not be high at approximately 8 per cent, but their immediately reliable assets —that is Treasury Bills, or call loans secured by bills are as high as 31 per cent of their deposits. There is, therefore, still considerable scope for the banking system in Britain to go on lending without being forced to liquidate their investments in gilt-edged securities. And, unless the banking system in any money market is at or nearing such a contingency, it cannot really be forced to be " in " the Bank. This is the technical reason behind the criticism that the rise in the bank rate in Britain is perhaps not sufficient to enable the authorities to achieve their declared aim.

Here the situation is more acute. The Reserve Bank's announcement that it will not buy securities on offer may force the banking system to be " in " the Bank. This, of course, depends upon the various rates of accommodation now fixed by the Imperial Bank, It has raised these rates. But it is significant that even the higher call rate to banks or advances against Government securities of Rs 5 lakhs and over remain at 3 per cent while the corresponding rate for similar advances below Rs 5 lakhs is still one-quarter per cent below the raised bank rate at 3¼ per cent.

In the circumstances, the bank rate may not be effective for the banks will be able to secure credit at will below the bank rate from the Imperial Bank by giving Government securities as collateral. In this context, it was significant that during the past busy season the market borrowed funds upto Rs 5 lakhs against Government Securities from the Imperial Bank by paying a quarter per cent more than the bank rate, instead of seeking accommodation from the Reserve Bank. It is an open secret that some banks are reluctant to take resort to the Reserve Bank because they do not like to disclose the nature of the securities provided as collateral In the circumstances these banks would prefer to borrow from the Imperial Bank, even if it raises its accommodation rates further, instead of borrowing from the Reserve Bank at the bank rate, of 3½ per cent. This calls for close co-operation between the Reserve Bank and the Imperial Bank not only to achieve the authorities' aim to force the market to be " in " the Bank, but also to enable them to exercise control over the quality of credit.

This apart, there are very definite reasons why the money market in India may be forced to be " in " the Bank. To appreciate this it is necessary to realise the money market developments since 1948. For between 1947 and 1949, India's external economy took a serious turn for the worse. She was incurring heavy deficits in her trade and payments balance. This phenomena was reflected in deflation of deposits, shrinking the resources of the money market. That, was how the scheduled banks were forced to liquidate their investment in gilt-edged securities.

Devaluation had a tonic effect on the country's trade and payments balances. An improvement in this balance was reflected in rising bank deposits. Both money incomes and money supplies increased. But, mainly due to the explosive rise in prices since, the start of the Korean war, the trade demand for funds increased appreciably. As stated in the Reserve Bank *communique* announcing the rise in the bank rate, bank advances during the busy season of 1950-51 reached the peak of Rs 586 crores, " the highest that has ever been recorded in any year during and after the war". Though bank deposits improved, the rate of bank advances rose faster. Sp, to meet the growing demand, banks were forced to disinvest.

For reasons entirely different, banks disinvested to the extent of Rs 200 crores since 1948, the year during which there was a phenomenal contra-seasonal stringency in. the money market during the import season. To the extent of approximately Rs 165 crores, sales of securities by banks were advanced by the Reserve Bank. That was how the deflationary effects of a deficit trade and payments balance and of an explosive rise in the demand for funds (as in the busy season of 1950-51) were partially offset.

Consider, now, the liquidity of our banking system. Cash resources of the scheduled banks compare favourably at over 12½ per cent of deposits. Compared with approxi mately 8 per cent in Britain. For more than two decades the banking

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system has vaunted over-liquidity, because of its fantastically high combined cash and investment ratio to deposits. During and since the war, the banks' investment rates have been nearer 55 per rent. Today it has come down to near 30 per cent. Thirty years ago, this would have evoked no comment. Today this low percentage of investment ratio at 31 per cent raising doubts about the liquidity of the banking system.

To some extent, the declining investment ratio is reflective of the gradual fall in gilt-edged prices. Admittedly, it has been encouraged by the fact that banks have found it convenient, as well as remunerative, to sell lower yielding gilt-edged securities to employ funds at higher yielding trade advances. There is an implied twist in the Reserve Bank *communique* that a portion of the advances is speculative. To prevent the banks from encouraging speculative or non-essential advances, the Reserve Bank has withdrawn the facility of buying securities on offer. This is aimed at discouraging disinvestment, as well as undesirable bank advances.

Hence,, the prevailing money market situation is such that even if the banks were not discouraged from selling securities at lower than their book value, they would have had to discover ways and means to maintain their investment portfolio to maintain liquidity. This means that if the demand for bank advances continues, banks will be forced to be " in " the Bank to cope with that demand. They are always assured of securing loans from the bank at the bank rate against approved securities as collateral. With restricted scope for disinvestment they will have to take, resort to the Bank to meet growing demand for funds. A borrower can lend only if he obtains rates higher than those which he pays. Thus, banks will have to charge appreciably more than the bank rate for making advances beyond a limit which is set by their current idle cash ratio. As this as well as the liquidity ratio is rather limited, bank advance rates are likely to move up. They have already been raised. That is how the Reserve Bank hopes to curtail both the supply and demand for credit.

# Weekly Notes

## *World Rice* Situation

It is now well nigh certain that food imports next year will have to be on the same colossal scale as in this year. The failure of monsoon will see to that. This will mean, for one thing, that the foreign exchange budget will be completely upset, despite some relief that may be expected from lower prices of cotton and jute. And since our crucial shortage is in rice rather than wheat, the light thrown on the world situation in rice in *The State of Food and Agricultural:* Review and Outlook for 1951, just published by the F.A.O. from Rome, will attract wide attention. It is a mixed picture that is presented in this review. All the features are by no means dark.

A considerable expansion in the area under cultivation of rice has been provisionally estimated as also higher production, though not proportionate to the increase in the area. China is expected to reach very near her pre-war production which has already been exceeded by the major producers while countries outside Asia which have greatly increased their rice production in the post-war years, still maintain it unchanged, leading to a net improvement in world supplies. This is the brighter side of the picture. An improvement in the export surplus in the Far East from 2.7 million metric tons in 1950 to 3.3 million metric tons is forecasted in 1951 while the. export surplus of the other regions will remain unchanged at one million metric tons.

On the other hand, the import demand from the Far-Eastern countries deficient in rice is expected to go up from 2.5 million metric tons to 3.1 million this year. So a higher export surplus of .6 million metric tons is likely to be matched by increased demand of the same amount. This should suggest at least ensuring the *status quo* and no worsening of the situation but for the impact of a new and disturbing factor, viz. augmented money incomes in the rice-deficient countries, following the post-Korean demand for their Export products. This has tended to increase the pressure of import demand reflected in higher export prices.

**International Trade in Rice**

| AREAS | 1934-38 Average Exports | 1934-38 Average Imports | 1949 Exports | 1949 Imports | 1950 Exports | 1950 Imports | 1951 Forecast Exports | 1951 Forecast Imports |
|---|---|---|---|---|---|---|---|---|
| | Million Metric tons | | | | | | | |
| Far East | 8.1 | 6.3 | 2.5 | 2.7 | 2.7 | 2.5 | 3.3 | 3.1 |
| Other Regions | 0.5 | 2.3 | 1.0 | 0.8 | 1.0 | 1.2 | 1.0 | 1.2 |
| World Total | 8.6 | 8.6 | 3.5 | 3.5 | 3.7 | 3.7 | 4.3 | 4.3 |

**World Area and Production of Rice**

| COUNTRY | AREA 1934-38 (Average) | AREA 1949/50 | AREA 1950/51 (Provisional) | PRODUCTION : PADDY 1934-38 (average) | PRODUCTION : PADDY 1949/50 | PRODUCTION : PADDY 1950/51 (Provisional) |
|---|---|---|---|---|---|---|
| | (........Million hectares....) | | | ( Million metric tons....) | | |
| China (22 Provinces) | 19.8 | 18.5 | 19.0* | 50.1 | 44.5* | 49.0* |
| India | 23.8 | 29.9 | 29.7 | 32.3 | 34.7 | 32.0* |
| Pakistan | 7.6 | 8.8 | 9.0 | 11.2 | 12.4 | 12.9 |
| Japan | 3.2 | 3.2 | 3.2 | 11.5 | 11.7 | 12.0 |
| Other Asian Countries | 26.2 | 25.2 | 25.6 | 37.8 | 36.1 | 36.1 |
| Total: Asia | 80.6 | 85.6 | 86.5 | 142.9 | 139.4 | 142.0 |
| Other Countries | 3.8 | 6.3 | 6.0 | 6.4 | 10.6 | 10.6 |
| World Total | 84.4 | 91.9 | 92.5 | 149.3 | 150.0 | 152.6 |

* Unofficial estimate.