# India: from loans to credit since 4000 years and the existence banks for 2500 years

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**The first credit in India dates back 4000 years. The existence of loans is proved to exist during the Vedic period, which is between 2000 and 1400 BC. The existence of banks in India dates back to 500 BC [1].**

A treatise on the art of politics of ancient India, the *Arthasastra* (attributed to Kautilya), dating from the 4th or 3rd century BC, mentions the existence of creditors, lenders and interest rates.

From the 12th century AD, banks developed all over India. Indian bankers issued bills of exchange called *Hundis* which were used for international trade [2]. And that was 2-3 centuries before the bankers in Western Europe issued bills of exchange.

According to the Western media, the first bank to be born on this planet was Italian. It was called Monte dei Paschi, founded in Siena in 1472. However, banks had existed in India for several centuries. W.E. Preston, member, Royal Commission on Indian Currency and Finance set up in 1926, observed "....it may be accepted that a system of banking that was eminently suited to India's then requirements was in force in that country many centuries before the science of banking became an accomplished fact in England". [3]

During the British rule over India from the mid-18th century to 1947, English capital dominated Indian banking system. Until independence, the entire banking system was private and poorly regulated.

The weak regulation was aggravated by the abolition of the unlimited liability of bankers. This development was imported from Western Europe. Indeed, capitalists in Europe and North America had obtained a favourable legislation. Until then, if the banks they owned went bankrupt, the courts could order the seizure of all assets to the extent of the amount of damage suffered. Immediately after the abolition of the unlimited liability of bankers, there was an increase in risk-taking and, as a result, an increase of bank failures.

The rural world and in particular the overwhelming majority of peasants had no access to banking services and they were handed over to usurers. Similarly, in the cities, artisans and small entrepreneurs did not have access to banking credit. From the 1900s onward, this led to the creation of credit cooperatives in both urban and rural areas which were hardly little affected by bankruptcies.

On the other hand, from 1913 to independence, there was an uninterrupted series of bank failures. 108 bankruptcies between 1913 and 1921, 215 bankruptcies between 1926 and 1935, 70 bankruptcies between 1936 and 1945.

Bank frauds and banking crises have been an integral part of the financial history of India under British rule. In 1913, John Maynard Keynes, after studying the state of the banking sector characterised "(the) *country as dangerous for banks*" [4]. In fact, the scams in the Indian banking sector predate Keynes' observation. The Presidency Bank of Bombay (PBB), set up by the British East India Company in 1840, was stable and prudently managed until the mid-1860s. It was at this time that the British began to rely heavily on the Bombay cotton markets, as supplies from the United States declined due to the civil war. As a result, many cotton companies emerged and banks began to sprout in Mumbai to meet the burgeoning demand for capital.

In this context, the PBB began to issue loans imprudently against shares in private companies and even on personal guarantees. Then, at the end of the US civil war, the euphoria in the Indian cotton market turned into panic. The previously stable bank quickly closed down [5]. A new Bank of Bombay was established immediately in 1868 since financial institutions were of course at the centre of the colonial project.

After independence in 1947, the country's central bank called the Reserve Bank of India was transformed into a 100% state-owned institution. It was given wide powers to control banks, which remain entirely privately owned. Nevertheless, these supervisory powers proved clearly insufficient, as a large number of bankruptcies, no less than 361 between 1947 and 1955, continued to occur.

Despite the nationalisation of the Imperial Bank [6] which led to the birth of the State Bank of India and the subsequent acquisition of eight banks controlled by the princely states [7] by the State Bank of India in 1959, the private banks abandoned the lower strata of the society as had been their practice during the colonial period. In rural areas, they lent to traders only. These traders, in turn, made financial advances to small rural producers, who had to repay at harvest time at lower than market prices, keeping them in poverty. Rural cooperatives were grossly underdeveloped and the overwhelming majority of farmers were handed over to traders and loan sharks.

**India's public banking sector : the historical perspective**

Since independence in 1947 to 1969, the Indian banking sector was largely dominated by private banks. This period was marked by numerous bank failures. In 1969, the then Prime Minister Indira Gandhi changed the course by strengthening state and public sector intervention in the economy (this led to a split with the right wing of her Congress party). In doing so, she sought to strengthen Indian capitalism and respond to certain popular demands. One of the measures taken was to nationalise fourteen banks in 1969. [8] Among other measures, it put an end to certain privileges given to princely states, inherited from the British period. The colonial rule allowed certain powers for the local rulers or the maharajahs.

In her own way, Indira Gandhi resorted to what the de Gaulle government had set up in France after the Second World War, known as the "*Circuit du Trésor*" [9]. The Treasury Circuit was a mechanism set up by the French government, after the liberation from the axis forces, to finance itself. It should be remembered that the *Bank of France* and four major deposit banks, under pressure from the movement from below, had been nationalised in 1945-1946. The *Treasury Circuit* allowed the French government to borrow without resorting to the financial markets. Banks were obliged to buy a quantity of French sovereign securities at the price and interest rate fixed in advance by the government. According to Benjamin Lemoine, this worked very well for more than thirty years and the amount of public debt was much lower than it became afterwards. It was only in the 1980s that this mechanism was completely abandoned as part of the neo-liberal offensive. Since the 1980s, France began to borrow at the financial markets from banks and other private financial companies.

The rules applied in India from 1969 onward are reminiscent of the *Treasury Circuit* applied in France at the same time but with even stricter provisions, something very positive.

India’s public banks had to place the equivalent of 20% of their assets with the central bank as a collateral against the risk of bankruptcy. They had to devote 40% of their assets to public debt securities, gold or cash. The remaining 40% was to be distributed in the form of credits according to predefined criteria called priority sector lending, which accorded significant priority to farmers, artisans and small and medium-sized enterprises in particular.

India’s big industrial bourgeoisie adapted very well to the existence of a large public banking sector, as it enabled them to fund their major expansion projects enormously. This was the case of large groups such as Tata (iron and steel), Birla (textiles and metallurgy) and others. This turning point for Indira Gandhi was predicated on an international context where India strengthened its military, diplomatic and economic relations with the Soviet Union. The Soviet model influenced India to adopt a planning system for large investments which favoured heavy industry.

The nationalisation of banks and the adoption of a state interventionist policy in the economy were primarily aimed at the strengthening of Indian big capital. It was also interested in protectionist measures against foreign competition. The orientation taken by Indira Gandhi also favoured the acceleration of the green revolution in Indian agriculture, which had unfavourable, even drastic, consequences for an important part of the peasantry which became dependent on the big seed companies, especially foreign ones (Monsanto, Syngenta... all supported also by the Ford Foundation and the World Bank) [10].

In 1980, the government carried out a second wave of bank nationalisation: 6 banks were nationalised. [11]

From the mid-1980s, structural adjustment policies began to be applied in India, as in the rest of the developing world. During a major balance of payments crisis that broke out in 1991, the government accelerated the implementation of structural reforms to deregulate the economy, increase foreign investment, privatise, reduce protectionist measures (by joining the World Trade Organisation as soon as it was launched in 1995). As a result of these reforms, the asset allocation requirements of banks were radically modified: the share of assets placed as collateral with the central bank decreased from 20% to 4.5%, and the share of assets to be allocated to public debt securities, gold and cash decreased from 40% to 19.5%. Interest rates, previously set by the Reserve Bank of India, were liberalised.

Then, the banking sector was opened to private capital. Seven new private banks entered the market between 1994 and 2000. In addition, more than 20 foreign banks started to operate in India since 1994. As of March 2004, the new private sector banks and foreign banks held a combined share of almost 20% of total assets. To sum it up, lending and deposit interest rates have been deregulated (the only remaining regulated rate is the savings deposit rate); the regulatory liquidity ratio has been lowered to 25%; prudential standards for banking capital have been set in line with Basel standards, i.e. lowered; accounting standards for provisions and non-performing assets have been strengthened; foreign banks have been given more freedom to enter the Indian market and existing banks have been allowed to open new branches; the lines between commercial banks (which focus on working capital) and development banks (which focus on long-term loans) have been blurred; new banks have been granted banking licences and mergers have been made possible.

The privatisation programme carried out under the aegis of neo-liberal reforms continues to gain ground with successive governments pushing it further. The current government initiatives speak of an outright sale of public sector banks to private capital. During the budget presentation in early February 2021, India’s finance minister announced the sale of two banks to the private sector. Although she did not name them in her 2021 budget speech, analysts pointed out that the Bank of Baroda (BoB) and the Punjab National Bank (PNB) are possible candidates for an early privatisation.

Recently, the Reuters news agency, in an exclusive release, revealed the names of the four shortlisted banks: Bank of Maharashtra, Bank of India, Indian Overseas Bank and Central Bank of India. Two high ranking officials told Reuters - on condition of anonymity since the case is not yet public – that two of these banks will be selected for sale in the 2021/2022 fiscal year, which begins in April. The shortlist has not yet been released.

**The scandalous story of the banking crisis**

The past century and a half has not been without its share of crises and controversies in the Indian banking sector. The Reserve Bank of India has tried to respond to all these crises by strengthening and adding regulations. Nevertheless, bank failures have continued in one form or another, even if at a much lesser degree. Even before the latest wave of crisis hitting banks like the Punjab National Bank, the Yes Bank and others, there were stock market scams in 1992 and 2001 due to fraudulent banking operations. Then there was the Indian Bank scam in 1996. Among the newly created banks in the 1990s, the Global Trust Bank played a major role in the 2001 stock market scam. Then there were the bad loan crises in the 1980s and 1990s.

All these failures, and the most recent ones, are somewhat confusing despite the strengthening of banking regulation over time. Indian banks are now governed by both international Basel standards and national regulations. The Reserve Bank of India which has extensive powers to inspect banks and intervene in their operations cannot absolve itself of responsibility.

Following the crises caused by the collapse of Lehman Brothers in 2008, India's banking sector was hailed. Indian bankers, it was said, did not follow so-called "Western fraudulent practices" and settled for the essentials. This idea is now being questioned and the extra-willingness of the fascist government to speed up privatisation must be fought.

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https://www.cadtm.org/India-from-loans-to-credit-since-4000-years-and-the-existence-banks-for-2500

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## Footnotes

[1] Reserve Bank of India – Publications, https://www.rbi.org.in/scripts/publicationsview.aspx?id=10487

[2] *Hundis* are the oldest form of credit instruments used as early as the 12th century AD. Deposits were accepted by certain local banks under the "*khata putta*" system. However, most native banks such as the *Multanis* and *Marwaris* did not accept deposits because they relied on their

own

[3] Indian Central Banking Enquiry Committee (1931), Chapter II page 11 cité dans Reserve Bank of India – Publications, https://www.rbi.org.in/scripts/publicationsview.aspx?id=10487

[4] John Maynard Keynes, *Indian Currency and Finance*, Macmillan and Co. 1913, London, 1913.

[5] Eric Toussaint succinctly described in the case of Egypt the debt crisis linked to the cotton boom at the time of the US civil war. See *Debt as an instrument of the colonial conquest of Egypt* https://www.cadtm.org/Debt-as-an-instrument-of-the

[6] Initially, in accordance with its Royal Charter, the *Imperial Bank* served as the central bank for British India before the creation of the *Reserve Bank of India* in 1950.

[7] The princely states were a stigma of British colonial domination, which in some territories had kept the *maharajahs* in power.

[8] The list of 14 banks nationalised in 1969 : Central Bank of India, Bank of Maharashtra, Dena Bank, Punjab National Bank, Syndicate Bank, Canara Bank, Indian Bank, Indian Overseas Bank, Bank of Baroda, Union Bank, Allahabad Bank, United Bank of India, UCO Bank, Bank of India

[9] See *Benjamin Lemoine*, *L'ordre de la dette*, *Éditions La Découverte*

[10] See Éric Toussaint, *Your Money or Your Life*, etc. ; also see Vandana Shiva, *The Violence of Green Revolution*, etc.

[11] The 6 banks nationalised in 1980 : Andhra Bank, Corporation Bank, New Bank of India, Oriental Bank of Commerce, Punjab and Sind Bank and Vijaya Bank