INTERNATIONAL BANKING

M.Com. (Banking)

SEMESTER-III, PAPER-I

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M.Com (Banking) - International Banking

First Edition : 2023

No. of Copies :

Published by:

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Centre for Distance Education,

Acharya Nagarjuna University

Printed at :

FOREWORD

Since its establishment in 1976, Acharya Nagarjuna University has been forging ahead in the path of progress and dynamism, offering a variety of courses and research contributions. I am extremely happy that by gaining 'A' grade from the NAAC in the year 2016, Acharya Nagarjuna University is offering educational opportunities at the UG, PG levels apart from research degrees to students from over 443 affiliated colleges spread over the two districts of Guntur and Prakasam.

The University has also started the Centre for Distance Education in 2003-04 with the aim of taking higher education to the door step of all the sectors of the society. The centre will be a great help to those who cannot join in colleges, those who cannot afford the exorbitant fees as regular students, and even to housewives desirous of pursuing higher studies. Acharya Nagarjuna University has started offering B.A., and B.Com courses at the Degree level and M.A., M.Com., M.Sc., M.B.A., and L.L.M., courses at the PG level from the academic year 2003-2004 onwards.

To facilitate easier understanding by students studying through the distance mode, these self-instruction materials have been prepared by eminent and experienced teachers. The lessons have been drafted with great care and expertise in the stipulated time by these teachers. Constructive ideas and scholarly suggestions are welcome from students and teachers involved respectively. Such ideas will be incorporated for the greater efficacy of this distance mode of education. For clarification of doubts and feedback, weekly classes and contact classes will be arranged at the UG and PG levels respectively.

It is my aim that students getting higher education through the Centre for Distance Education should improve their qualification, have better employment opportunities and in turn be part of country's progress. It is my fond desire that in the years to come, the Centre for Distance Education will go from strength to strength in the form of new courses and by catering to larger number of people. My congratulations to all the Directors, Academic Coordinators, Editors and Lesson- writers of the Centre who have helped in these endeavors.

Prof. P. Raja Sekhar
Vice-Chancellor
Acharya Nagarjuna University

M.Com. (Banking)
Semester –III
311CO21- INTERNATIONAL BANKING
Syllabus

Learning Outcomes:

After successful completion of this course, the students will be able to:

1. *Acquire knowledge of Commercial Banking System*
2. *Know the concepts relating to federal reserve system and European Monetary Union*
3. *Understand the Reserve Bank of India functions and NABARD*
4. *Comprehend the New Development Banks*

Syllabus :

Unit-I: Introduction: Concept of Money Market, Deployed and Less Deployed Money Market, their characteristics & importance. English Banking System – Bank of England, Origin and Growth, Organizational Structure, Functions, Monitory Policy, Commercial Banking System.

Unit–II: Federal Reserve System: Origin, Organizational Structure and Working, Commercial Banking in USA, Unit Banking and Branch Banking and Factors for its growth to USA, New York Money Market.

Unit–III: European Monetary Union: European Central Bank, Organization structure and Functions . Bank of Japan - Structure and Working, Commercial Banking system of Japan, Industrial Banking in Japan.

Unit –IV: Indian Banking - Reserve Bank of India, Functions, Monetary and Credit policy and Evaluation , Achievements and Failures of R.B.I. Indian Money Market, Constituents, Characteristics, Defects and Measures , Banking Reforms in India, NABARD.

Unit-V: International Financial Institutions – I.M.F. and I.B.R.D., I.D.A., IFC, BRICS – New Development Bank.

REFERENCE BOOKS:

1. Sayers R.S.- Modern Banking.
2. Basu S.K. Contemporary Banking Trends.
3. Saxena K.B. – International Banking: Banking Theory and Principle Banking Systems
4. Machenize K. – Banking Systems of Great Britain, French, Germany and U.S.A.
5. Goswami V.K. International Banking.

CONTENTS

LESSON-1
MONEY MARKET

AIMS AND OBJECTIVES

After studying this lesson, you should be able to
1. Define the term “concept of money market,
2. Objectives of Money market

STRUCTURE

1.1. INTRODUCTION

The money market is one of the pillars of the global financial system. It involves overnight swaps of vast amounts of money between banks and the U.S. government. The majority of money market transactions are wholesale transactions that take place between financial institutions and companies. Institutions that participate in the money market include banks that lend to one another and to large companies in the euro-currency and time deposit markets; companies that raise money by selling commercial paper into the market, which can be bought by other companies or funds; and investors who purchase bank CDs as a safe place to park money in the short term. The money market plays a unique role in signalling the stance of the monetary policy and in transmitting monetary policy decisions to financial markets more generally, to private spending and saving decisions, and ultimately to monetary dynamics and the determination of the price level. It is only when the normal, stable relationships in the money market break down – as was the case, at least temporarily, during the summer – that the centrality of their role becomes fully apparent. The need for a money market arises because receipts of economic units do not coincide with their expenditures. These units can hold money balances—that is, transactions balances in the form of currency, demand deposits, or NOW accounts—to insure that planned expenditures can be maintained independently of cash receipts. Holding these balances, however, involves a cost in the form of foregone interest. The money market encompasses a group of short-term credit market instruments, futures market instruments, and the Federal Reserve's discount window.

1.1. a). Meaning and Definition

The major purpose of financial markets is to transfer funds from lenders to borrowers. Financial market participants commonly distinguish between the "capital market" and the "money market," with the latter term generally referring to borrowing and lending for periods of a year or less. Money market basically refers to a section of the financial market where financial instruments with high liquidity and short-term maturities are traded. Money market has become a component of the financial market for buying and selling of securities of short-term maturities, of one year or less, such as treasury bills and commercial papers. Money market consists of negotiable instruments such as treasury bills, commercial papers. and certificates of deposit. It is used by many participants, including companies, to raise funds by selling commercial papers in the market. Money market is considered a safe place to invest due to the high liquidity of securities. Finance companies typically fund themselves by issuing large amounts of asset-backed commercial paper (ABCP), which is secured by the pledge of eligible assets into an ABCP conduit. Examples of eligible assets include auto loans, credit card receivables, residential/commercial mortgage loans, mortgage-backed securities and similar financial assets.

Meanwhile, a mortgage lender can create protection against a fallout risk by entering an agreement with an agency or private conduit for operational, rather than mandatory, delivery of the mortgage. In such an agreement, the mortgage originator effectively buys an option, which gives the lender the right, but not the obligation, to deliver the mortgage. Against that, the private conduit charges a fee for allowing optional delivery. Some large corporations with strong credit rating issue commercial paper on their own credit. Other large corporations arrange for banks to issue commercial paper on their behalf. In the United States, federal, state and local governments all issue paper to meet funding needs. States and local governments issue municipal paper, while the U.S. Treasury issues Treasury bills to fund the U.S. public debt:

i) Trading companies often purchase bankers' acceptances to tender for payment to overseas suppliers. ii) Retail and institutional money market funds iii) Banks iv) Central banks v) Cash management programs vi) Merchant banks.

1.1. b) Major Participants In Money Market

The major participants in the money market are commercial banks, governments, corporations, government-sponsored enterprises, money market mutual funds, futures market exchanges, brokers and dealers, and the Federal Reserve.

i. Commercial Banks: Banks play three important roles in the money market. First, they borrow in the money market to fund their loan portfolios and to acquire funds to satisfy noninterest-bearing reserve requirements at Federal Reserve Banks. Banks are the major participants in the market for federal funds, which are very short-term—chiefly overnight—loans of immediately available money; that is, funds that can be transferred between banks within a single business day. The funds market efficiently distributes reserves throughout the banking system. The borrowing and lending of reserves takes place at a competitively determined interest rate known as the federal funds rate.

ii. Corporations: Nonfinancial and nonbank financial businesses raise funds in the money market primarily by issuing commercial paper, which is a short-term unsecured promissory note. In recent years an increasing number of firms have gained access to this market, and commercial paper has grown at a rapid pace. Business enterprises—generally those involved in international trade—also raise funds in the money market through bankers acceptances.

iii. Futures Exchanges: Money market futures contracts and futures options are traded on organized exchanges which set and enforce trading rules. A money market futures contract is a standardized agreement to buy or sell a money market security at a particular price on a specified future date. There are actively traded contracts for 13-week Treasury bills, three-month Eurodollar time deposits, and one-month Eurodollar time deposits. There is also a futures contract based on a 30-day average of the daily federal funds rate.

iv. Dealers and Brokers: The smooth functioning of the money market depends critically on brokers and dealers, who play a key role in marketing new issues of money market instruments and in providing secondary markets where outstanding issues can be sold prior to maturity. Dealers use RPs to finance their inventories of securities. Dealers also act as intermediaries between other participants in the RP market by making loans to those wishing to borrow in the market and borrowing from those wishing to lend in the market.

1.1. c) Nature of Money Markets

The orderly functioning of the money market is of the utmost importance for the transmission of the key policy rates to the economy in general and the price level in particular. Market participants form expectations about the future path of the very short-term rates based on anticipated monetary policy decisions. These expectations are the basis for the determination of longer maturity interest rates and yields that are relevant for spending and saving decisions and which ultimately influence economic and monetary developments and the price level.

i. It is a wholesale market, as the transaction volume is large.
ii. The money market is an unregulated and informal market.
iii. Money market gives lesser return to investors who invest in it but provides a variety of products.
iv. Trading takes place over the telephone, after which written confirmation is done by way of emails
v. Participants include banks, mutual funds, investment institutions and Central Banks.
vi. There is an impersonal relationship between the participants in the money market, and so, pure competition exists.
vii. Money market operations focus on a particular area, which serves a region or an area. On the basis of the market size and needs, the area may differ.

1.2. SCOPE & FEATURES OF MONEY MARKET

The money market provides non-inflationary sources of finance to the government. It is possible by issuing treasury bills to raise short loans. However, this does not lead to increases in prices.

Money Market consists of all the organizations and institutions which deal or facilitate dealings in short term debt instruments. These institutions include RBI, commercial banks, cooperative banks, non-banking financial companies like LIC, GIG, UTI, and special institutions like Discount and Finance House of India (DFHI).

1.2.1. Scope of Money Market

Efficient, liquid and deep money markets provide greater flexibility for market participants to manage funds for funding and investment purposes as well as other economic activities. Therefore, Bank Indonesia is required to accelerate the money market deepening process through comprehensive regulations, licensing, development and supervision in terms of the various money market transactions and instruments. Money Market Regulations comply with prevailing state treasury laws in terms of utilising government debt securities (SUN) as a monetary instrument through monetary operations based on repurchase agreements (repo). Furthermore, Money Market Regulations provide a solid legal foundation for market participants as a reference and a form of legal assurance when transacting in the money market.

i. It is a market for short term financial needs, for example, working capital needs.
ii. It’s primary players are the Reserve Bank of India (RBI), commercial banks and financial institutions like LIC, etc.,
iii. It is highly liquid as it has instruments that have a maturity below one year.
iv. Most of the money market instruments provide fixed returns.
v. It maintains a balance between the supply of and demand for the monetary transactions done in the market within a period of 6 months to one year..
vi. It enables funds for businesses to grow and hence is responsible for the growth and development of the economy.
vii. It aids in the implementation of monetary policies.
viii. It helps develop trade and industry in the country. Through various money market instruments, it finances working capital requirements. It helps develop the trade in and out of the country.
ix. The short term interest rates influence long term interest rates. The money market mobilizes the resources to the capital markets by way of interest rate control.
x. It helps in the functioning of the banks. It sets the cash reserve ratio and statutory liquid ratio for the banks. It also engages their surplus funds towards short term assets to maintain money supply in the market.
xi. The current money market conditions are the result of previous monetary policies. Hence it acts as a guide for devising new policies regarding short term money supply.
xii. Instruments like T-bills, help the government raise short term funds. Otherwise, to fund projects, the government will have to print more currency or take loans leading to inflation in the economy. Hence the it is also responsible for controlling inflation.

1.3. OBJECTIVES OF MONEY MARKET

i) Providing borrowers such as individual investors, government, etc. with short-term funds at a reasonable price. Lenders will also have the advantage of liquidity as the securities in the money market are short-term.
ii) It also enables lenders to turn their idle funds into an effective investment. In this way, both the lender and borrower are at a benefit.
iii) RBI regulates the money market. Therefore, in turn, helps to regulate the level of liquidity in the economy.

iv) Since most organizations are short on their working capital requirements. The money market helps such organizations to have the necessary funds to meet their working capital requirements.
v) It is an important source of finance for the government sector for both national and international trade. And hence, provides an opportunity for the banks to park their surplus.

1.4 . PRINCIPLES OF MONEY MARKET

The following principles are of particular relevance for managing the relationship between money market tensions and monetary policy decisions.

i. Maintains Liquidity in the Market: One of the most crucial functions of the money market is to maintain liquidity in the economy. Some of the money market instruments are an important part of the monetary policy framework. RBI uses these short-term securities to get liquidity in the market within the required range. Money market is an important arm of financial markets in developing economies. It facilitates dealing in short-dated, fixed income funds and securities. The interbank segment of money market is usually active, vibrant and challenging. Interbank dealers make and lose money dependent on how they anticipate market risk. It is necessary—in order to anticipate risk—for the dealers to be well versed in the intricacies of the mechanisms of money markets.

ii. Provides Funds at a Short Notice: Money Market offers an excellent opportunity to individuals, small and big corporations, banks of borrowing money at very short notice. These institutions can borrow money by selling money market instruments and finance their short-term needs.

iii. Utilization of Surplus Funds: Money Market makes it easier for investors to dispose off their surplus funds, retaining their liquid nature, and earn significant profits on the same. It facilitates investors' savings into investment channels. These investors include banks, non-financial corporations as well as state and local government.

iv. Aids in Financial Mobility: Money Market helps in financial mobility by allowing easy transfer of funds from one sector to another. This ensures transparency in the system. High financial mobility is important for the overall growth of the economy, by promoting industrial and commercial development.

v. Helps in monetary policy:A developed money market helps RBI in efficiently implementing monetary policies. Transactions in the money market affect short term interest rate, and short-term interest rates gives an overview of the current monetary and banking state of the country. This further helps RBI in formulating the future monetary policy, deciding long term interest rates, and a suitable banking policy.

1.5 POLICIES AND PROCEDURES OF MONEY MARKET

1.5 a) Policies of Money Market

i. Trade without discrimination: Under the WTO agreements, countries cannot normally discriminate between their trading partners. Grant someone a special favour and you have to do the same for all other WTO members. Imported and locally-produced goods should be treated equally — at least after the foreign goods have entered the market. The same should apply to foreign and domestic services, and to foreign and local trademarks, copyrights and patents.

ii. Freer trade: gradually, through negotiation: Lowering trade barriers is one of the most obvious means of encouraging trade. The barriers concerned include customs duties (or tariffs) and measures such as import bans or quotas that restrict quantities selectively. The WTO agreements allow countries to introduce changes gradually, through "progressive liberalization"

iii. Predictability: through binding and transparency: With stability and predictability, investment is encouraged, jobs are created and consumers can fully enjoy the benefits of competition — choice and lower prices. The multilateral trading system is an attempt by governments to make the business environment stable and predictable.

iv. Promoting fair competition

v. Encouraging development and economic reform

1.5 b) Procedure of trading in Money Market:

i. Selection of Broker: One can buy and sell securities only through the brokers registered and who are members of the stock exchange. A broker can be a partnership firm, an individual, or a corporate body. Hence, the first step of the trading procedure is the selection of a broker who will buy/sell securities on the behalf of a speculator or investor..

ii. Opening Demat Account with Depository: An account that must be opened with the Depository Participant for trading in the listed securities in electronic form is known as Demat (Dematerialized) Account or Beneficial Owner (BO) Account.

iii. Placing the Order: The next step after the opening of a Demat Account is the placing of an order by the investor. The investor can place the order to the broker either personally or through email, phone, etc. The investor must make sure that the order placed clearly specifies the range or price at which the securities can be sold or bought. For example, an order placed by Kashish is, "Buy 200 equity shares of Nestle for no more than ₹200 per share."

iv. Match the Share and Best Price: The broker after receiving an order from the investor will have to then go online and connect to the main stock exchange to match the share and best price available.

v. Executing Order: When the shares can be bought or sold at the price mentioned by the investor, it will be communicated to the broker terminal, and then the order will be executed electronically. Once the order has been executed, the broker will issue a trade confirmation slip to the investors.

vi. Issue of Contract Note: Once the trade has been executed within 24 hours, the broker will issue a contract note. A contract note consists of the details of the number of shares bought or sold, the date, time of the deal, price of securities, and brokerage.

vii. Delivery of Share and making Payment: The investor has to deliver the shares sold or has to pay cash for the shares bought. The investor has to do so immediately after receiving the contract note or before the day when the broker shall make delivery of shares to the exchange or make payment. This is known as Pay in Day.

viii. Settlement Cycle: The payment of securities in cash or delivery of securities is done on Pay in Day, which is before T+2 Day.

ix. Delivery of Shares or Making Payment: On the T+2 Day, the Stock Exchange will then deliver the share or make payment to the other broker. This is known as Pay out Day. Once the shares have been delivered of payment has been made, the broker has to make payment to the investor within 24 hours of the pay out day, as he/she has already received payment from the exchange.

x. Delivery of Shares in Demat Form: The last step of the trading procedure is making delivery or shares in Demat form by the broker directly to the Demat Account of the investor. The investor is obligated to give details of his Demat Account and instruct his Depository Participant (DP) for taking delivery of securities directly in his beneficial owner account.

1.5. c) Functions of Money Market

i. To maintain the balance between the demand and supply for money when it comes to short-term money-related transactions(monetary equilibrium)
ii. To promote economic growth. The money market can do this by making funds available to various units in the economy such as agriculture, small scale industries, etc.
iii. To provide help to Trade and Industry. The money market provides adequate finance to trade and industry. Similarly, it also provides the facility of discounting bills of exchange for trade and industry.
iv. To help in implementing Monetary Policy. It provides a mechanism for the effective implementation of the monetary policy.
v. To help in Capital Formation. The money market makes available investment avenues for the short term period. It helps in generating savings and investments in the economy.

1.6. DEVELOPED MONEY MARKET

A developed money market consists of a number of specialized sub-markets dealing in various types of credit instruments. There is the call loan market, the bill market, the Treasury bill market, the collateral loan market and the acceptance market, and the foreign exchange market.

Characteristics of Developed Money Market:

i. Existence of central bank
ii. Highly organized commercial banking system
iii. Existence of sub-markets
iv. Healthy competition in sub markets
v. Integrated structure of money market

vi. Availability of proper credit instruments
vii. Adequacy and elasticity of funds
viii. International attraction
ix. Uniformity of interest rates
x. Stability of prices and highly developed industrial system

1.6. a) Importance of developed money market

A developed money market is essential for the economic progress of a country. The importance of the developed money market can be summarized as follows:

(a) It provides finance to trade and industry when needed.
(b) It provides profitable outlet for the short-term funds of the commercial banks.
(c) It helps the government to raise necessary short-term funds by sale of treasury bills
(d) It helps the Central Bank in the following ways:
(e) Attracts foreign funds.

1.7 UNDEVELOPED OR LESS DEVELOPED MONEY MARKET

The undeveloped money market consists of the moneylenders, the indigenous bankers, traders, merchants, landlords, pawnbrokers, etc. There is multiplicity of interest rates. Interest rates are much higher than rates in the developed sector of the money market. The interest rates are not even uniform. The rate depends on the need of the borrower, the amount of loan, the time for which it is required and the nature of security.

1.7.1. Characteristics of Less developed Money Market

i. The lenders have a personal touch with the borrowers. The lender knows every borrower personally.
ii. There is no rigidity in loan transactions. The borrower can have more or less amount of loan according to his requirements depending upon the nature of security or his goodwill with the moneylender.
iii. Mostly people do not specialize is money-lending alone. They combine money-lending with other economic activities.
iv. There is multiplicity of interest rates. Interest rates are much higher than rates in the developed sector of the money market.
v. The undeveloped sector is not linked with the developed sector of the money market in such countries.
vi. In the unorganized sector of the money market, the system of maintaining accounts is highly defecate.

1.7.2. Commercial Securities in Money Market

Money Market development requires the development of money market instruments, including Commercial Securities. Commercial securities are money market instruments issued by non-bank corporations with a maturity of up to one year as an alternative form of short-term funding or liquidity management available to non-bank corporations. Meanwhile, the development of commercial securities as a money market instrument will provide greater liquidity management flexibility for Market Participants. The regulations on commercial securities are focused on creating a qualified investor base. Qualified investors have strong investment knowledge and understand the risks. One way to create a qualified investor base is by enforcing a lower limit on purchases of Commercial Securities.

1.7.3. Gilt-Edged Market

The Gilt-edged market refers to the market for government and semi-government securities, backed by the RBI. The term gilt-edged means 'of the best quality'. It is known so because the government securities do not suffer from the risk of default and are highly liquid. The RBI is the sole supplier of such securities. These are demanded by commercial banks, insurance companies, provident funds, and mutual funds.

The gilt-edged market may be divided into two parts- the Treasury bill market and the government bond market. Treasury bills are issued to meet short-term needs for funds of the government, while government bonds are issued to finance long-term developmental expenditure.

1.7.4. Outlook of Money Market

Money market conditions in the euro area have improved. We should nonetheless guard against complacency and recognise that the process of normalisation is likely to be drawn out. Further action on the part of the private sector is necessary to build confidence and improve transparency. The end of the year, which is typically a period of some tension in the money market, is set to be an important test of the resilience of the gradual improvement in money market conditions we have seen in recent weeks. As President Trichet announced on 8 November, the Governing Council has decided to roll-over the supplementary LTROs, such that this longer maturity liquidity extends across the end-year period, in the interests of providing continuity and reassurance to the markets that should support confidence. Looking further ahead, the lessons of the recent turmoil for the conduct of liquidity policy and the design of the operational framework have to be identified and their implications digested. Nonetheless, I remain confident that our current framework and practice have performed well in the face of considerable challenges in recent months. From the *macroeconomic and monetary policy perspective* the current financial turmoil has had a limited impact on the expansion of economic activity in the euro area, at least so far. However, the turmoil is not yet over. Through time, a higher degree of transparency in financial markets will both contribute to a better functioning of the money market and provide a richer picture of the impact of the turmoil on credit conditions and the real economy. Thus far, the dynamism of the world economy has also proved to be resilient. However, regional patterns of growth have changed. The moderation of economic growth in the US economy has been at least partly compensated by sustained growth in emerging market economies. Whether economic and financial developments in the US will spill over to other regions in the world depends on the significance of the various potential transmission channels.

The months to come will show whether the so called "decoupling hypothesis" will prove to be correct. In the US, concerns about housing market developments, and their potential consequences for consumer and investor confidence as well as for private consumption (*inter alia*) weigh heavily on growth prospects. From today's perspective a temporary dampening effect for the growth perspectives in the euro area cannot be excluded. At the same, risks to price stability in the euro area continue to be on the upside and appear to have increased and intensified recently. Earlier this year, we had already expected that inflation would rise further towards the end of 2007 and early 2008, reflecting base effects stemming from the third and the fourth quarter of 2006. We communicated to the public along these lines.

However, the annual HICP inflation rate for October was a surprisingly high 2.6 %, mainly driven by a sharp rise in oil and non-oil commodities including agricultural prices, which led to renewed upward pressures on energy and food price developments. Moreover, domestic price pressures remain strong in the euro area. Against this background it is very likely that headline inflation will remain elevated in the months to come. Although HICP inflation is expected to moderate in the second half of 2008, the inflation rate is likely to remain above 2 % for most of next year. In the context of continued capacity constraints, in particular in the labour market, there is a high risk that this might trigger high wage growth in the months to come. It is crucial that all parties concerned meet their responsibilities to avoid second-round effects.

The Governing Council has explicitly clarified that it will monitor all developments very closely and stands ready to prevent *any* second-round effects in response to these pressures. While recognising that the interpretation of the monetary data is to some extent clouded by the possible impact of financial turmoil, the monetary analysis continues to support the view that upside risks to price stability prevail at medium to longer horizons. The need for a careful interpretation of the incoming data places a premium on the assessment of a broad range of monetary and financial data in coming to an overall assessment. Such a broad-based analysis supports the view that the underlying rate of money and credit growth remains strong, even if M3 growth somewhat overstates this underlying strength as the flattening of the yield curve and the general rise in risk aversion may have increased the demand for M3 deposits. Bank loans continue to grow strongly, particularly to the non-financial corporate sector, which both underpins the view that the underlying pace of monetary expansion is strong and points against any significant impairment to bank credit supply stemming from the turmoil in money markets. On the basis of its economic and monetary analyses, and by acting in a firm and timely manner, the ECB will ensure that upside risks to price stability over the medium term do not materialise and that medium and long-term inflation expectations remain firmly anchored in line with price stability. This will thereby favour an environment conducive to sustained economic growth, well-functioning markets and job creation. Providing such an anchor for medium and long-term inflation expectations is all the more important at times of financial market volatility and increased uncertainty. As regards the financial markets, although improving, the situation in the money market is not yet back to normal. It thus appears necessary to pay great attention to developments over the period to come and to stand ready to act if needed, but of course without impinging on or prejudicing the delivery of price stability. Against this background, taking also into account the continuation of heightened uncertainty over recent months, it is also necessary for the time being to gather additional information before drawing further conclusions for monetary policy, fully in line with our monetary policy strategy focused on maintaining price stability over the medium term.

1.7.5. Money Market and Foreign Exchange Market Service Providers

Fair, regulated, transparent, liquid and efficient financial markets with integrity can be realised through reliable and integrated financial market infrastructure. One form of financial market infrastructure is the means to implement transactions through a platform to set prices and interact with Market Participants as follows:

1. Electronic Trading Platform, namely a business entity established specifically to provide certain facilities used to interact and/or transact in the money market and/or foreign exchange market.

2. Money Market and Foreign Exchange Market Brokers, namely a business entity established specifically to provide certain transaction facilities for service users and earn a return on the services provided.
3. Systematic Internalisers, namely banks that provide certain facilities to perform transactions in the money market and/or foreign exchange market using its own account with Service Users.
4. Futures Exchange Providers, namely futures exchanges in accordance with prevailing laws on commodities futures trading, providing specific facilities for service users to transact in the money market and/or foreign exchange market.

1.7.6. Money Market Futures

Money market futures are futures contracts based on short-term interest rates. Futures contracts for financial instruments are a relatively recent innovation. Four different futures contracts based on money market interest rates are actively traded at present.

Futures Contracts:

Futures contracts traditionally have been characterized as exchange-traded, standardized agreements to buy or sell some underlying item on a specified future date. For example, the buyer of a Treasury bill futures contract—who is said to take on a "long" futures position—commits to purchase a 13-week Treasury bill with a face value of $1 million on some specified future date at a price negotiated at the time of the futures transaction; the seller—who is said to take on a "short" position—agrees to deliver the specified bill in accordance with the terms of the contract. In contrast, a "cash" or "spot" market transaction simultaneously prices and transfers physical ownership of the item being sold.

1.7.6. a) Futures Exchanges

In addition to providing a physical facility where trading takes place, a futures exchange determines the specifications of traded contracts and regulates trading practices. Trading takes place in designated areas, known as "pits," on the floor of the futures exchange through a system of open outcry in which traders announce bids to buy and offers to sell contracts. Traders on the floor of the exchange can be grouped into two broad categories: floor brokers and floor traders. Floor brokers, also known as commission brokers, execute orders for off-exchange customers and other members. Some floor brokers are employees of commission firms, known as Futures Commission Merchants, while others are independent operators who contract to execute trades for brokerage firms. Floor traders are independent operators who engage in speculative trades for their own account. Floor traders can be grouped into different classifications according to their trading strategies. "Scalpers," for example, are floor traders who perform the function of marketmakers in futures exchanges.

1.7.6. b) Futures Commission

Merchants A Futures Commission Merchant (FCM) handles orders to buy or sell futures contracts from off-exchange customers. All FCMs must be licensed by the Commodity Futures Trading Commission (CFTC), which is the government agency responsible for regulating futures markets.

1.7.6 c) Role of the Exchange

Clearinghouse Each futures exchange has an affiliated exchange clearinghouse whose purpose is to match and record all trades and to guarantee contract performance. In most cases the exchange clearinghouse is an independently incorporated organization, but it can also be a department of the exchange.

1.8. SUMMARY

Money markets offer a platform for dealers to trade short-dated, fixed-income funds and securities. In doing so, dealers make and lose money dependent on how they anticipate market risk. In order to correctly anticipate risk, the dealers must appreciate the intricacies of the dynamics of money markets. A practice common to the dealers is hedging against market risk. In most cases, speculations on markets volatility, the quest for arbitrage gains, and expectations on interest rates movements underlie both the market risk and the drive to hedge against it in developing economies. Frauds infiltration of the markets tends to exacerbate the risks the dealers face. These are real issues—and major challenges for the money market dealers. I investigate the dynamic of strict risk-mitigation rules of dealing procedures in money markets, and how the supposedly binding rules on the dealers often are infringed—worsening concerns about market risk. The money market consists of financial institutions and dealers in money or credit who wish to either borrow or lend. Participants borrow and lend for short periods, typically up to twelve months.. Finance companies typically fund themselves by issuing large amounts of asset-backed commercial paper (ABCP), which is secured by the pledge of eligible assets into an ABCP conduit. Examples of eligible assets include auto loans, credit card receivables, residential/commercial mortgage loans, mortgage-backed securities and similar financial assets. Some large corporations with strong credit rating issue commercial paper on their own credit. Other large corporations arrange for banks to issue commercial paper on their behalf. Developed money markets help commercial banks to become self-sufficient. In an emergency, when commercial banks have scarcity of funds, they need not approach the central bank and borrow at a higher interest rate. The ECB has an interest in contributing to the functioning of money markets. However, neither the ECB nor any other central bank can ensure that the money market is always shielded from volatility and turmoil. As recent events have shown, market participants' behaviour – reflecting underlying trust, confidence and transparency over which the ECB exerts little direct influence – are the prerequisites for a well functioning market.

1.9. TECHNICAL TERMS

Reserve Bank of India: The Reserve Bank of India (RBI) is the central bank of India, which was established on April 1, 1935, under the Reserve Bank of India Act. The Reserve Bank of India uses monetary policy to create financial stability in India, and it is charged with regulating the country's currency and credit systems. Understanding the Reserve Bank of India (RBI)

Money Market: The money market refers to trading in very short-term debt investments. At the wholesale level, it involves large-volume trades between institutions and traders. At the retail level, it includes money market mutual funds bought by individual investors and money market accounts opened by bank customers.

Bank of England: The Bank of England. Promoting the good of the people of the United Kingdom by maintaining monetary and financial stability.

Demat Account: A Demat Account is a bit like a bank account for your share certificates and other securities that are held in an electronic format. Demat Account is short for dematerialisation account and makes the process of holding investments like shares, bonds, government securities, Mutual Funds, Insurance and ETFs easier, doing away the hassles of physical handling and maintenance of paper shares and related documents.

1.10. SELF ASSESSMENT QUESTIONS

1. What is money market? Explain the characteristics and principles of money market?
2. Write a note on developed and less developed money market?
3. The Money market is the market for medium and long term funds. Explain.

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Dr. B. Padmaja

LESSON-2
ENGLISH BANKING SYSTEM

OBJECTIVES

After studying this lesson, you should be able to

1. Understand "English Banking System,
2. Know the Origin and Growth of Bank of England
3. Aware about Structure of the Bank of England
4. Financial Policy Committee & Prudential Regulation Authority

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STRUCTURE

2.1. INTRODUCTION: ESSENTIALS OF A SOUND BANKING SYSTEM

A bank plays a very critical role in the development of the economy of a country. A sound banking system ensures that the development is all-round. In this article, we will look at the essential features of a sound banking system. A sound banking system has four essential aspects :liquidity, expansion, investments and loan policies, and the human factor. Let's look at these aspects in detail.

i. Adequate Liquidity: A bank offers types of deposits to customers – demand deposit, time deposits, CASA deposit, and NRO. Therefore, a bank needs to keep adequate cash in hand to meet the withdrawal requests of depositors. If it fails to do so, then the bank would be insolvent. Banks must have adequate cash in hand to meet the withdrawal requests of depositors on a daily basis. Failing to do so can adversely affect the customers as well as other banks as people start losing their trust in the banking system. Further, bank failure affects depositors as well as other banks. One bank failing makes people lose their trust in the banking system and hence they tend to avoid depositing funds with the banks. Therefore, a bank must ensure that it has adequate liquidity at all times to ensure its safety.

ii. Expansion of Banking: In any economy, it is important that banking services are spread across all sections of people. A sound banking system is present throughout the economy and offers funds for all productive activities in society. In fact, the less-developed regions and segments of society must receive more banking facilities than the others. Therefore, the diffusion of banking services is essential. In an economy, banking services must spread across the different sections of the society. Further, the under-developed regions or segments of society must have greater access to banking services.

iii. Investment and Loan Policies: A bank has dual goals – liquidity and profitability. Therefore, a sound banking system needs to have a sound investment policy to help the bank achieve these goals. It is important to remember that if a bank’s loan and/or investments go wrong, then it can suffer losses or liquidity shortage. Therefore, a prudent banker carefully determines the composition and character of its loans and advances in order to optimize the earning without putting its safety and solvency at risk. It must have a sound investment policy to achieve the goals of profitability as well as liquidity.

iv. Human Factor: As an industry, banking relies heavily on the quality of people working in it. Banking is a practical affair. Therefore, one cannot rigidly apply the laws of banking as it does not bear fruit. Hence, a lot depends on the people working in the industry. Thus, a sound banking system depends more on the banking personnel than on the laws. A sound banking system depends more on the personnel working in it than the banking laws.

The English banking system before the Panic of 1825, apart from the Bank of England, which maintained a monopoly of joint-stock banking, was one of private partnerships both in London and in the provinces, most of which were independent unit banks. Since remittance was the principal function of country banks at this time close ties in the form of correspondent relations developed between country banks and London agents, similar to the structure prevailing in the United States later in the nineteenth century between New York and interior banks. Although efficient in the transfer of funds across space, these networks also proved to be quite efficient in the transmission of financial pressures during panics.

2.2. BANK OF ENGLAND

Over the years the Bank of England has become the "bankers' bank" and banker to the Government: that is to say, the central bank of the United Kingdom. The principal banks in the United Kingdom, by custom, keep a substantial part of their total cash holdings in the form of balances at the Bank: these are the great "clearing" banks, familiar to the public through their network of branches. Others that keep accounts with the Bank of England include those banks whose principal business is overseas, the central banks of other countries and the members of the London Money Market.

The Bank of England (BoE) is the United Kingdom’s central bank and serves the U.K. government as the official banking institution for monetary affairs. The central offices of the BoE are in Threadneedle in London’s financial district, which is also the basis of its nickname, “the Old Lady of Threadneedle Street.” The Bank of England is the world’s eighth oldest bank and a structural model for most central banks around the world. It was established in 1694 as a private entity and remained private for 250 years until it was nationalized in 1946. In 1998, the BoE evolved to become an independent public organization wholly owned by the Treasury Solicitor. In addition, the Bank of England acts as the official gold custodian of the U.K and other central banks worldwide. The bank’s vaults hold about 400,000 gold bars estimated to be worth over £200 billion and represent about 3% of all gold mined in history.

2.2.1. **Who owns the Bank of England?**

There are some people who believe that the Bank of England is owned by the Royal family, but that's not true. It's also not true that the Bank of England is owned by some group of private individuals, or that it is a corporation. So who does own the Bank of England then? Up until 1946 the Bank of England was a corporation, with outstanding shares owned by private citizens. When the Bank was nationalized in 1946 there were roughly 17,000 shareholders, although less than one third of them held more than £1,000 worth of stock. Today the central bank is wholly owned by the UK government, specifically by the HM Treasury. Yet the Bank of England remains independent and free from government influence.

2.2.2. How does the Bank of England work?

As the central bank for the United Kingdom the Bank of England serves several functions that are necessary for the economic functioning of the country. These functions include the creation of currency, regulation of the banking industry, maintaining stable prices, and encouraging economic growth. They perform these functions by moving interest rates up and down to encourage or discourage inflation and growth, by printing physical currency, and by creating regulations that tell UK commercial banks how to perform their functions.

2.2.3. What is the advantage to having the Bank of England?

While it isn't the primary function of the central bank, one of the most important reasons for having the central bank is that it functions as the lender of last resort. If you want a loan you go to a bank, but where does a bank go when it needs a loan. To the central bank of course, and in the case of the UK this is the Bank of England. Commercial banks have historically been subject to runs, or panic withdrawals that can bankrupt a bank in a matter of minutes. When this happens the central bank stands ready to support the entire banking system.

2.2.4. The Bank of England in Fundamental Analysis: The influence of the BoE on the U.K. economy is based mostly on the interest rate decisions and other economic interventions by the Monetary Policy Committee. The committee meets eight times a year to evaluate the economic performance in the light of monetary policy goals for , , and. When the figures are wide off the mark, positively or negatively, the MPC can use the tools at its disposal to bring the economy back on track. The main tools of the MPC are interest rate decisions, asset purchase facilities, and minimum reserve requirements. Each tool aims to modify the money supply in circulation, whereby greatly impacting the value of the British Pound Sterling and other U.K. assets.

2.2.5. BoE Interest Rate Hike: When the U.K. economy is performing too well, rising inflation can cause unemployment due to high salary demands of the employees and lead to reduced consumer spending. The MPC can adopt a hawkish attitude and slowdown the growth with an interest rate hike, which would add value to GBP. Higher interest rates would increase the yields of relatively passive securities like savings, and U.K. Gilts, which would encourage the investors to redirect their active capital from riskier assets. At the same time, expensiveness of loans would discourage people from adding more cash into the economy, thereby reducing the demand, and slowing down the inflation.

2.2.6. BoE Interest Rate Cut: In an opposite scenario, when the economy is underperforming, the BoE can use stimulations such as interest rate cuts and asset purchase programs. Reducing the interest rates would allow people to loan and contribute to consumption economy, while encouraging businesses to make more investments and increase employment. Lower interest rates would also attract passive capital to . Investors would be expecting the companies to expand their business operations and increase production. Eventually, the profitability of the companies would increase and yield higher stock dividends.

2.2.7. How to Trade with the Bank of England Decisions?

Bank of England interest rate decisions by the MPC have strong implications on the values of the British Pound Sterling, the in the London Stock Exchange (LSE), and the U.K. Government Bonds. Hence, the BoE central bank meetings are anticipated eagerly by the news trading strategists in the financial markets, and the market turmoil is until the meeting starts. At the conclusion of a meeting, the bank announces the decisions with an official statement. The BoE Governor holds a press conference to explain the bank's economic outlook and the reasoning behind their decisions. Minutes of the meeting are also released, which contains the discussions of the MPC members and give information about what they expect to happen in the near future.

If the BoE decides to decrease the interest rates, in congruence with analyst forecasts, the GBP and the bonds will lose value, while U.K. stocks and, possibly, commodities will rise. If they raise the interest rates, GBP will gain value against other currencies, the bonds will rise, and the stocks will drop. However, under abnormal economic circumstances like recession, the market reaction would depend on the expectations towards the measures BoE might take. The extremely volatile reactions usually happen when the market sentiment shifts dramatically due to a surprise development. The sentiment is often affected by the clues in the meeting minutes and press conference more than the actual decisions.

Large-scale investors base their long-term investments on how the BoE (and, therefore, them) thinks the future will shape for the British economy and take positions accordingly. As such, when the BoE takes investors by surprise, the U.K. assets experience wide price movements, which create many high-risk & high-return opportunities.

2.2.8. Trading the Bank of England Events with AvaTrade: The BoE Monetary Policy Committee meets eight times a year to make interest rate decisions, every event can be as golden as the bank's precious metal reserves. Following the monitored by the MPC and performing a thorough can reveal the potential BoE interest rate hikes and cuts. With professional support from a broker like AvaTrade, you can take advantage of the opportunities that arise from the Bank of England central bank meetings.

2.2.8. BoE Events Schedule: Check AvaTrade's to learn the time and date of the next BoE event, and mark it on your calendar. A Rich Selection of U.K. Assets: and British assets like , , and with great trading conditions. Be Prepared for Everything: As a , AvaTrade enables trading both directions of the price with Long and , and without having to physically purchase them! Manage Risk with Confidence: against the during BoE interest rate decisions using AvaTrade's own .

Trade in All Territories: , our mobile trading application, to trade the British securities as events happen, regardless of the time or your location.

Never Walk Alone: Our award-winning customer support team is ready to assist you for BoE events and all other matters in multiple languages via chat, email, and phone.
The Royal Family trusts the Bank of England with its wealth and monetary affairs. Now that you know how the BoE takes care of the economy and how the MPC interest rate decisions

affect the value of GBP and other British assets, get yourself prepared with AvaTrade's state-of-the-art trading tools and start trading with confidence!

2.3. ORIGIN AND GROWTH OF BANK OF ENGLAND

Bank of England, the central bank of the United Kingdom. Its headquarters are in the central financial district of the City of London. The Bank of England was incorporated by act of Parliament in 1694 with the immediate purpose of raising funds to allow the English government to wage war against France in the Low Countries (*see* Grand Alliance, War of the). A royal charter allowed the bank to operate as a joint-stock bank with limited liability. No other joint-stock banks were permitted in England and Wales until 1826. This special status and its position as the government's banker gave the bank considerable competitive advantages. The bank was privately owned until 1946, when it was nationalized. It funds public borrowing, issues bank notes, and manages the country's gold and foreign-exchange reserves. It is an important adviser to the government on monetary policy and is largely responsible for implementing the chosen policy by its dealings in the money, bond, and foreign-exchange markets. The bank's freedom of action in this regard was considerably enhanced when it was given the power to determine short-term interest rates in 1997. The Bank of England is a member of the European Central Bank and part of its General Council. Developments in the 20th century were dominated by the two World Wars. The disappearance of golden sovereigns and half-sovereigns from circulation began during the 1914-1918 War, when currency notes for £ 1 and 1 OS. were issued by the Treasury through the Bank. These notes were replaced in 1928 by Bank of England notes of similar denominations. "White" Bank notes were first issued early in the 18th century and those of £5 and upwards remained legal tender until 1943 when all except the £5 note were withdrawn; the issue of this denomination was eventually discontinued in 1957 and it was replaced by the modern type of coloured note which is more difficult to forge and lends itself to printing on the most advanced machinery.

2.3.1. The major points to be covered are as follows:

- **i.** King William and Queen Mary founded the bank in 1688.
- **ii.** The bank started with a initial loan of 1.2m GBP to the government.
- **iii.** Public finances are dried at that time and government paid 8% per anum interest and service charge of £4000.
- **iv.** 1844 bank charter act tied the issue of notes to gold reserves and gave the bank sole right regarding issue of notes.
- **v.** The bank act as a lender in the panic of 1866.
- **vi.** Britain remain on gold standard until 1931 and after 1945 bank followed Keynesian economy i.e, low interest rates, easy money.
- **vii.** In 1997 bank setup a wholly owned subsidiary called bank of England nominees Ltd.
- **viii.** Prior to 1997 bank was one of the least independence central bank.
- **ix.** In 1997 labour government came into power, the chancellor exchequer, Gordon brown made a surprise announcement.
- **x.** Under bank of England act 1998,the monetary policy committee given power to set interest rates

2.3.2. Functions of Bank of England

The principal function of the Bank of England is to ensure and maintain financial stability and monetary stability. Financial stability is achieved by the cooperation of the FPC and the PRA, while monetary stability is in the MPC's responsibility.

i. Financial Stability: The FPC strives to maintain the operational health of the national finance system by identifying systemic risks and supporting the government's economic policy. On the other hand, the PRA regulates banks, financial institutions, and financial markets to ensure the integrity and fairness of the financial services provided to British consumers.

ii. Monetary Stability: The MPC's responsibility for monetary stability involves maintaining stable prices in the economy and controlling the GBP value. It reaches the objectives by planning the country's monetary policy, setting the United Kingdom interest rates, and intervening the economy when the alarm bells are ringing. Overseeing the national economic health.

iii. Other functions include:

a. Issuing banknotes, , and governing the value of British Pound Sterling (GBP)
b. Planning and executing monetary policy in alignment with the government's
c. Implementing economic interventions to manage the economic growth
d. Regulating and ensuring the integrity of banks, financial institutions, and financial markets
e. Acting as the lender of last resort in financial matters
f. Custodianship of the gold reserves in the United Kingdom.

2.4. STRUCTURE OF THE BANK OF ENGLAND

The hierarchical structure of the Bank of England is comprised of the Governor, the Court of Directors, and a few subcommittees. The Governor of BoE is selected from within the bank, holding the most senior executive position and participating in all committees. The Court of Directors is the main administrative body and oversees the bank's operations, strategies, and resource allocations. Among the prominent subcommittees:

a) Monetary Policy Committee (MPC) implements monetary policy and sets the interest rates.
b) Financial Policy Committee (FPC) ensures stability in the financial system.
c) Prudential Regulation Authority (PRA) regulates the Financials industry

2.4. a) **Monetary Policy**

Monetary policy is action that a country's central bank or government can take to influence how much money is in the economy and how much it costs to borrow. As the UK's central bank, we use two main monetary policy tools.

First, we set the interest rate that we charge banks to borrow money from us – this is Bank Rate.

Second, we can buy bonds to lower the interest rates on savings and loans through quantitative easing (QE). Monetary policy affects how much prices are rising – called the rate of inflation. We set monetary policy to achieve the Government's target of keeping inflation at 2%.Low and stable inflation is good for the UK's economy and it is our main monetary policy aim.

2.4. a. i) Monetary Policy Committee (MPC):

The Monetary Policy Committee (MPC) is made up of nine members – the Governor, the three Deputy Governors for Monetary Policy, Financial Stability and Markets and Banking, our Chief Economist and four external members appointed directly by the Chancellor.

External members are appointed to make sure that the MPC benefits from thinking and expertise from outside of the Bank of England. A representative from HM Treasury also sits with the MPC at its meetings. The Treasury representative can discuss policy issues, but is not allowed to vote. They are there to make sure that the MPC is fully briefed on fiscal policy developments and other aspects of the Government's economic policies, and that the Chancellor is kept fully informed about monetary policy. Each member of the MPC has expertise in the field of economics and monetary policy. Members do not represent individual groups or areas – they are independent. MPC members serve fixed terms, after which they may be either replaced or reappointed.

Unit-I: Introduction: Concept of Money Market, Deployed and Less Deployed Money, Market, their characteristics & importance. English Banking System – Bank of England, Origin and Growth, Organizational Structure, Functions, Monitory Policy, Commercial Banking System.

2.4. a. ii) Monetary Policy Committee (United Kingdom)

The Monetary Policy Committee (MPC) is a committee of the Bank of England, which meets for three and a half days, eight times a year, to decide the official interest rate in the United Kingdom (the Bank of England Base Rate). It is also responsible for directing other aspects of the government's monetary policy framework, such as quantitative easing and forward guidance. The Committee comprises nine members, including the Governor of the Bank of England, and is responsible primarily for keeping the Consumer Price Index (CPI) measure of inflation close to a target set by the government, currently 2% per year (as of 2019).[1] Its secondary aim – to support growth and employment – was reinforced in March 2013. Announced on 6 May 1997, only five days after that year's General Election, and officially given operational responsibility for setting interest rates in the Bank of England Act 1998, the committee was designed to be independent of political interference and thus to add credibility to interest rate decisions. Each member has one vote, for which they are held to account: full minutes of each meeting are published alongside the committee's monetary policy decisions, and members are regularly called before the Treasury Select Committee, as well as speaking to wider audiences at events during the year.

The committee is responsible for formulating the United Kingdom's monetary policy,[2] most commonly via the setting of the rate at it which it lends to banks (officially the Bank of England Base Rate or BOEBR for short).[3] As laid out in law, decisions are made with a primary aim of price stability, defined by the government's inflation target (2% per year on the Consumer Price Index as of 2016).[2] The target takes the form of a "point", rather than the "band" used by the Treasury prior to 1997.[4] The secondary aim of the committee is to support the government's economic policies, and help it meet its targets for growth and employment.[2] That secondary aim was reinforced by then Chancellor of the Exchequer George Osborne in his March 2013 budget, with the MPC given more discretion to more openly "trade off" above-rate inflation in the medium run to boost other economic indicators.[5] The MPC is not responsible for fiscal policy, which is handled by the Treasury itself,[4] but is briefed by the Treasury about fiscal policy developments at meetings.[3]

Under the Bank of England Act 1998 the Bank's Governor must write an open letter of explanation to the Chancellor of the Exchequer if inflation exceeds the target by more than one percentage point in either direction, and once every three months thereafter until prices are back within the allowed range. It should also set out what plans the Bank has for rectifying the problem, and how long it is expected to remain at those levels in the meantime.[2] In January 2009 the Chancellor announced an Asset Purchase Facility (APF), to be administered by the MPC, aimed at ensuring greater liquidity in financial markets.[6] The committee had already started to cut rates the previous autumn, but the effect of such changes can take up to two years and rates cannot go below zero. By March 2009, faced with very low levels on inflation and interest rates already at 0.5%, the MPC voted to start the process of quantitative easing (QE) – the injection of money directly into the economy – via the APF. It had the Bank buy government bonds (gilts), along with a smaller amount of high-quality debt issued by private companies.[7] Although non-gilts initially made up a non-negligible part of the APF portfolio, as of May 2015 the entirety of the APF was held as gilts.[8] On 7 August 2013, Governor Mark Carney issued the committee's first forward guidance as a third tool for controlling future inflation.[9]

Criticism of the MPC has centred on its predominant focus on inflation to the detriment of growth and employment,[2] although that criticism may have been mitigated by the March 2013 revisions to the committee's remit. There have also been complaints about the reluctance of lenders to pass on rate changes,[10] and about the extent to which the introduction and management of QE have risked politicising the committee.[11]

2.4.a. iii) History:

Traditionally, the Treasury set interest rates. After reforms in 1992, officials held regular meetings and published minutes, but were not independent of government.[4] The result was a feeling that political factors were clouding what should be purely economic judgements on monetary policy.[10]

On 6 May 1997, operational responsibility to set interest rates was granted to the independent Bank of England by the Chancellor of the Exchequer, Gordon Brown.[10] Guidelines for the creation of a new "Monetary Policy Committee" were laid out in the Bank of England Act 1998. The Act also set out the responsibilities of the MPC: it would meet monthly; its membership comprise the Governor, two Deputy Governors, two of the Bank's Executive Directors and four members appointed by the Chancellor. It should publish minutes of all meetings within six weeks (in October 1998 the committee announced plans to publish far more quickly, after only one[12]). The Act gave the government responsibility for specifying its price stability target and growth and employment objectives at least annually.[13] The original inflation target the government set for the MPC was 2.5% per year on the RPI-X measure of inflation, but in 2003 this was changed to 2% on CPI.[4] The government reserved the right to instruct the Bank on what rate to set in times of emergency.[14]

The years 1998 to 2006 witnessed an unprecedented period of price stability – during which inflation stayed within a percentage point of the target – despite earlier predictions that it could sit outside the range forty or more percent of the time. A 2007 report produced for the Treasury Committee noted that the MPC's independence of government "has reduced the scope for short-term political considerations to enter into the determination of interest rates". The creation of the MPC, it said, brought with it "an immediate credibility gain".[4] During this time, the MPC kept interest rates relatively stable between 3.5% and 7.5%.[15]

However, the financial crisis of 2007–08 ended this period of stability, and, on 16 April 2007, the governor (at that time Mervyn King), was obliged to write the first MPC open letter to the chancellor (Gordon Brown), explaining why the inflation had deviated from the target of 2% per year by more than one percentage point (3.1%).[16] By February 2013, he had had to write 14 such letters to chancellors.[17] Between October 2008 and March 2009 the base rate was cut six times to an all-time low of 0.5% in order to avoid deflation and spur growth. In March 2009, the MPC launched a programme of quantitative easing, initially injecting £75 billion into the economy.[18] By March 2010, it had also increased the amount of money set aside for quantitative easing to £200 billion,[19] a figure later increased by a further £75 billion in the months following October 2011.[20] The MPC announced two further £50 billion rounds of quantitative easing in February[21] and July 2012,[22] bringing the total to £375 billion whilst simultaneously keeping the base rate at 0.5%.[22] In March 2013, the Chancellor of the Exchequer, George Osborne, called on the MPC to follow its American counterpart (the Federal Reserve Board) in committing itself to keeping interest rates low for a prolonged period of time via appropriate forward guidance,[5] which it did on 7 August.[9]

These measures eventually proved insufficient to avoid deflation. Having taken over in August 2013, Governor Mark Carney wrote his first open letter in February 2015 to explain why inflation had fallen below 1% for the first time in the MPC's history.[23] This was followed by deflation of 0.1% in April 2015, the first month of negative CPI growth since the 1960s, and triggering a second letter.[24] As of February 2015, Carney has written five such letters.[25] Following the UK's in June 2016, the MPC cut the base rate from 0.5% to 0.25%, the first change since Marcvote to leave the European Unionh 2009.[26] At the same time, it announced a further round of quantitative easing, valued at £60 billion, bringing the total to £435 billion.[26]

In December 2014, the Bank adopted the recommendations of a report prepared by Kevin Warsh aimed at improving the transparency of the committee's decision making processes.[27]

2.4.a. iv) Composition: Following a reshuffle in April 2014, the committee currently comprises:[3]The Governor of the Bank

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- The three Deputy Governors for Monetary Policy, Financial Stability and Markets and Banking
- The Bank's Chief Economist
- Four external members, appointed by the Chancellor of the Exchequer for a renewable three-year term

Each member has one vote of equal weight,[3] for which they can be held publicly accountable.[4] The Governor chairs the meeting and is the last to cast a vote, acting as a casting vote in event of a tie.[28] Representatives from the Treasury may attend the meeting, but only as non-voting observers.[3]

2.4.a. v) Meetings: The MPC meets eight times a year,[3] including four joint meetings with the Financial Policy Committee.[27] After a half-day "pre-MPC meeting", usually the

Wednesday before, meetings are held over three days, typically a Thursday, Monday and Wednesday.[3] Prior to the implementation of the reforms recommended by Kevin Warsh, meetings were generally held monthly on the Wednesday and Thursday following the first Monday of the month, although this was sometimes deviated from. In 2010, for example, the meeting was postponed from the 5/6 to the 7/10 May in order to avoid conflicting with the general election schedule for the 6th.[29] The May 2015 meeting was similarly delayed.[30]

On the first day of the three, the Committee studies data relating to the UK economy, as well as the worldwide economy, presented by the Bank's economists and regional representatives, and topics for discussion are identified and addressed.[3] The second day consists of a main policy discussion during which MPC members explain their personal views and debate the correct course of action.[3] The Governor chooses the policy most likely to command a majority and, on the third day of the meeting, a vote is taken; each member gets one vote.[3] Those in the minority are asked to give the action they would have preferred.[3] The committee's decisions are announced at noon the day after the meeting has concluded.[28] Following a procedural change in 2015, minutes of each meeting (including the policy preference of each member) are published on the Bank's website at the same time as any decision is announced, resulting in a "Super Thursday" effect.[31] Prior to August 2015, the committee's decisions were published at noon on the final day of the meeting, but there was a two-week delay before any minutes were published.[32] Starting with the March 2015 meeting, full transcripts of meetings will also be published, albeit after an eight-year delay.[27]

Outside of meetings, members of the MPC can be called upon by Parliament to answer questions regarding their decisions, via parliamentary committee meetings, often those of the Treasury Committee. MPC members also speak to audiences throughout the country, with the same aim. Their views and expectations for inflation are also republished in the Bank's quarterly inflation report.[3]

2.4.a. vi) Membership: As of September 2022, the current Committee comprises:[33]

i. Andrew Bailey (16 March 2020 to 15 March 2028, Governor)
ii. Ben Broadbent (1 July 2014 - 30 June 2024, Deputy Governor for Monetary Policy)
iii. Dave Ramsden (1 September 2017 – 31 August 2022, Deputy Governor for Markets and Banking)
iv. Jon Cunliffe (1 November 2013 - 31 October 2023, Deputy Governor for Financial Stability)
v. Huw Pill (6 September 2021 - 5 September 2024, Chief Economist and Executive Director for Monetary Analysis)
vi. Jonathan Haskel (1 September 2018 - 31 August 2024, external member)
vii. Silvana Tenreyro (5 July 2017 - 4 July 2023, external member)
viii. Catherine L. Mann (1 September 2021 - 31 August 2024, external member)
ix. Swati Dhingra (9 August 2022 - 8 August 2025, external member)

2.4.a. vii) Other, former members of the committee by date of appointment are:

i. Sir Edward George (June 1997 – June 2003)
ii. Howard Davies (June – July 1997)
iii. Willem Buiter (June 1997 – May 2000)
iv. Charles Goodhart (June 1997 – May 2000)
v. Ian Plenderleith (June 1997 – May 2002)

vi. Mervyn King (June 1997 – June 2013)
vii. DeAnne Julius (September 1997 – May 2001)
viii. David Clementi (September 1997 – August 2002)
ix. Sir Alan Budd (December 1997 – May 1999)
x. Sir John Vickers (June 1998 – September 2000)
xi. Sushil Wadhwani (June 1999 – May 2002)
xii. Christopher Allsopp (June 2000 – May 2003)
xiii. Stephen Nickell (June 2000 – May 2006)
xiv. Charles Bean (October 2000 – June 2014)
xv. Kate Barker (June 2001 – May 2010)
xvi. Marian Bell (June 2002 – June 2005)
xvii. Paul Tucker (June 2002 – 20 October 2013)
xviii. Sir Andrew Large (September 2002 – January 2006)
xix. Richard Lambert (June 2003 – March 2006)
xx. Rachel Lomax (July 2003 – June 2008)
xxi. David Walton (July 2005 – 21 June 2006)
xxii. Sir John Gieve (16 January 2006 – March 2009)
xxiii. David Blanchflower (June 2006 – May 2009)
xxiv. Tim Besley (September 2006 – August 2009)
xxv. Andrew Sentance (October 2006 – May 2011)
xxvi. Spencer Dale (July 2008 – May 2014)
xxvii. Paul Fisher (March 2009 – July 2014)
xxviii. David Miles (June 2009 – August 2015)
xxix. Adam Posen (September 2009 – August 2012)
xxx. Martin Weale (August 2010 – July 2016)
xxxi. Mark Carney (July 2013 - March 2020)
xxxii. Kristin Forbes (July 2014 – June 2017)
xxxiii. Nemat Shafik (August 2014 – February 2017)
xxxiv. Charlotte Hogg (March 2017 – 28 April 2017)
xxxv. Ian McCafferty (September 2012 – August 2018)
xxxvi. Andy Haldane (1 June 2014 - June 2021)
xxxvii. Gertjan Vlieghe (September 2015 – August 2021)
xxxviii. Michael Saunders (9 August 2016 - 9 August 2022)

The dates listed show when their current terms of appointment are due to, or did, end.

As of January 2008, Mervyn King, the Bank of England's then Governor, was the only MPC member to have taken part in every meeting since 1997.[34] As a result, after the MPC meeting in July 2013, the first after King retired, no single member had attended every meeting. As of 2016, Kate Barker is the only external member to date to have been appointed for three terms, each lasting three years.[35]

2.5. FINANCIAL POLICY COMMITTEE

The Financial Policy Committee (FPC) is an official committee of the Bank of England, modelled on the already well established Monetary Policy Committee. It was announced in 2010 as a new body responsible for monitoring the economy of the United Kingdom.[1] Focusing on the macro-economic and financial issues that may threaten long term growth prospects,[2] it was expected to be officially set out in legislation during 2012.[1] Although early plans were for the interim (pre-legislation) FPC to meet in late 2010, the committee's first meeting was held in June 2011.[3] As of March 2012, the FPC is expected to take over operational responsibility for managing the financial sector from the Financial Services Authority with legislation planned for 2013.[4]

Once operational, the committee, headed by the Governor of the Bank (currently Andrew Bailey), will address any risks it identifies by passing on its concerns to a new Prudential Regulation Authority (PRA), which will be obliged to act.[2] Plans for the committee were set out in George Osborne's first Mansion House speech in June 2010, along with the creation of the PRA and a Consumer Protection and Markets Authority (CPMA, later renamed the Financial Conduct Authority, or FCA).[1] Minutes of FPC meetings are made available,[4] a move intended both "to increase transparency and to help transmit messages to the City".[2] After legislation is passed, the FPC will be fully accountable to Parliament.[1]

2.5.1. Legislation : Legislation is the process or result of enrolling, enacting, or promulgating laws by a legislature, parliament, or analogous governing body.[1] Before an item of legislation becomes law it may be known as a bill, and may be broadly referred to as "legislation" while it remains under consideration to distinguish it from other business. Legislation can have many purposes: to regulate, to authorize, to outlaw, to provide (funds), to sanction, to grant, to declare, or to restrict. It may be contrasted with a non-legislative act by an executive or administrative body under the authority of a legislative act.[2]

Overview: Legislation is usually proposed by a member of the legislature (e.g. a member of Congress or Parliament), or by the executive, whereupon it is debated by members of the legislature and is often amended before passage. Most large legislatures enact only a small fraction of the bills proposed in a given session.[3] Whether a given bill will be proposed is generally a matter of the legislative priorities of the government. Legislation is regarded as one of the three main functions of government, which are often distinguished under the doctrine of the separation of powers. Those who have the formal power to create legislation are known as legislators; a urtication of government will have the formal power to interpret legislation (see statutory interpretation); the executive branch of government can act only within the powers and limits set by the law, which is the instrument by which the fundamental powers of government are established.[4]

2.5.2. The Financial Services Authority (FSA): The Financial Services Authority (FSA) was a quasi-judicial body accountable for the regulation of the financial services industry in the United Kingdom between 2001 and 2013. It was founded as the Securities and Investments Board (SIB) in 1985. Its board was appointed by the Treasury, although it operated independently of government. It was structured as a company limited by guarantee and was funded entirely by fees charged to the financial services industry.[1][2] Due to perceived regulatory failure of the banks during the financial crisis of 2007–2008, the UK government decided to restructure financial regulation and abolish the FSA.[3] On 19 December 2012, the Financial Services Act 2012 received royal assent, abolishing the FSA with effect from 1 April 2013. Its responsibilities were then split between two new agencies: the Financial Conduct Authority and the Prudential Regulation Authority of the Bank of England. Until its abolition, Lord Turner of Ecchinswell was the FSA's chairman[4] and Hector Sants was CEO until the end of June 2012, having announced his resignation on 16 March 2012.[5] Its main office was in Canary Wharf, London, with another office in Edinburgh.

2.6. PRUDENTIAL REGULATION AUTHORITY (UNITED KINGDOM)

The **Prudential Regulation Authority** (**PRA**) is a United Kingdom financial services regulatory body, formed as one of the successors to the Financial Services Authority (FSA).[1][2][3] The authority is responsible for the prudential regulation and supervision of banks, building societies, credit unions, insurers and major investment firms. It sets standards and supervises financial institutions at the level of the individual firm.[1][2][3][4][5] Although it was initially structured as a limited company wholly owned by the Bank of England, the PRA's functions have now been taken over by the Bank and are exercised through the Prudential Regulation Committee.[6] The company has since been liquidated.[7]

The PRA was created by the Financial Services Act 2012 and formally began operating alongside the new Financial Conduct Authority on 1 April 2013.[1] As the Bank of England is operationally independent of the Government of the United Kingdom, the PRA is a quasi-governmental regulator, rather than an arm of the government *per se*.[2] The PRA has its main offices at 20 Moorgate, near the Bank of England's central offices on Threadneedle Street.[8]

2.6.1. Role: The PRA's role is defined in terms of two statutory objectives: to promote the safety and soundness of the firms it regulates and, specifically for insurers, to contribute to the securing of an appropriate degree of protection for policyholders (section 12 of the PRA Statement of Policy).[9] In promoting safety and soundness, the PRA focuses primarily on the harm that firms can cause to the stability of the UK financial system. A stable financial system is one in which firms continue to provide critical financial services – a precondition for a healthy and successful economy.

It will have close working relationships with other parts of the Bank, including the Financial Policy Committee and the Special Resolution Unit.[10] The PRA's most significant supervisory decisions are taken by the Prudential Regulation Committee – comprising the Governor of the Bank of England, the Deputy Governor for Financial Stability, the Deputy Governor for Monetary Policy, the Deputy Governor for Markets & Banking, the chief executive officer of the PRA (and Deputy Governor for Prudential Regulation) and independent non-executive members.[11]

2.6.2. The PRA's approach to regulation and supervision has three characteristics:[12]

i. A judgment-based approach: The PRA will use judgement in determining whether financial firms are safe and sound, whether insurers provide appropriate protection for policyholders and whether firms continue to meet the threshold conditions.

ii. A forward-looking approach: The PRA will assess firms not just against current risks, but also against those that could plausibly arise in the future. Where the PRA judges it necessary to intervene, it will generally aim to do so at an early stage.

iii. A focused approach: The PRA will focus on those issues and those firms that pose the greatest risk to the stability of the UK financial system and policyholders.

The PRA approach to supervision will not seek to operate a "zero-failure" regime. Rather, the PRA will seek to ensure that a financial firm which fails does so in a way that avoids significant disruption to the supply of critical financial services.[13]

2.6.3. List of chief executives: The chief executive of the PRA is also the Bank of England Deputy Governor for Prudential Regulation. The following is a list of chief executives since the PRA's inception: Name: Andrew Bailey, Period: 2013–16; Sam Woods: 2016–

2.6.4. History: From 1 April 2013, the Prudential Regulatory Authority, alongside the Financial Conduct Authority, replaced the Financial Services Authority.[14] In response to the onset of the COVID-19 pandemic in the United Kingdom in March 2020, the PRA sent a formal request to the seven largest British lenders to suspend dividends and share repurchases until the end of the year.[15][16]

2.7. SUMMARY

The principal banks in the United Kingdom, by custom, keep a substantial part of their total cash holdings in the form of balances at the Bank: these are the great "clearing" banks, familiar to the public through their network of branches. In its capacity as the Government's banker, the Bank renders the services that any bank offers to its customers, not the least significant of which is advice on monetary matters. The most important function of a bank is to collect deposits from the public and lend those deposits for the development of business, agriculture, trade and commerce. The main purpose of commercial banks is to provide financial services to the general public and also provide loan facilities to the business which helps in ensuring economic stability and growth of the economy. Therefore, we can say that credit creation is the most important purpose of commercial banks. There is a greater demand today for building solutions & platforms that can easily integrate & collaborate with other fintechs, corporate treasurers, financial organizations, bank data & compliance systems to provide seamless customer experiences. In order to build such platforms, commercial banks need to restructure their functional and technical architecture and IT ecosystems in the near future.

2.8. TECHNICAL TERMS

Bank of England:	The Bank of England. Promoting the good of the people of the United Kingdom by maintaining monetary and financial stability.
Monetary Policy:	Monetary policy is a set of tools used by a nation's central bank to control the overall money supply and promote economic growth and employ strategies such as revising interest rates and changing bank reserve requirements.
English Banking System:	The English banking system before the Panic of 1825, apart from the Bank of England, which maintained a monopoly of joint-stock banking, was one of private partnerships both in London and in the provinces, most of which were independent unit banks. Since remittance was the principal function of country banks at this time close ties in the form of correspondent relations developed between country banks and London agents, similar to the structure prevailing in the United States .
Inter. Money Market:	The International Money Market The international money market is a market where international currency transactions between numerous central banks of countries are carried on. The transactions are mainly carried out using gold or in US dollar as a base.

2.9. SELF ASSESSMENT QUESTIONS

1. Explain the origin and growth of Bank of England
2. Give the organization structure and major functions of Bank of England?
3. What is the main purpose of commercial banks?

2.10. SUGGESTED READINGS

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Dr. B. Padmaja

LESSON-3
DIFFERENT TYPES OF BANKS IN INDIA

AIMS AND OBJECTIVES

After studying this lesson student should be able to

- Know the Different Types of Banks in India
- History of the Indian Banking System
- Understand the features & Functions of Reserve Bank of India
- Importance of RRBs, LABs, Payment Banks

STRUCTURE

3.1. INTRODUCTION: HISTORY OF THE INDIAN BANKING SYSTEM

Ancient India included the use of ‘Usury’. There was also the existence of loans called ‘Rnapatra’, ‘Rnapanna’, or ‘Rnalekhaya’. Moreover, there was the use of ‘Adesha’ or ‘Letters Of Credit’.In the Medieval Era, there was a use of ‘Dastawez’ including the ‘Dastawez-E-Indultalab’ and the ‘Dastawez-E-Miadi’. In the Colonial Era, the ‘Bank Of Calcutta’ was established in 1806 and is the oldest bank which is still in function just with a change in title originally formed by the presidency government. Also, the ‘Commercial Bank’ started in 1845. The ‘Union Bank of Calcutta’ was started in 1829 replacing the ‘Bank Of Calcutta’ and the ‘Commercial Bank The ‘Bank of Hindustan’ started in 1770 but shut down in 1829 – 1832. The ‘General Bank of India’ started in 1786 but disassociated in 1791. The ‘Bank Of Bombay’ started in 1840 formed by the presidency government. The ‘Bank of Madras’ started in 1843 formed by the presidency government.3 banks formed by the presidency government were then combined to form the ‘Imperial Bank Of India’ in 1921. The ‘Reserve Bank Of India’ started in 1935.According to the State Bank of India Act, 1959 the ‘State Bank Of India’ was given under the supervision of 8 connected banks. In 1969, 14 major private banks nationalized including the ‘Bank of India’. In 1980, 6 more banks were nationalized.The ‘Allahabad Bank’ started in 1865. The ‘Grindlays Bank’ started in 1864, Calcutta.The ‘Comptoir d’Escompte de Paris’ started a branch in 1860, Calcutta and another in 1862, Bombay. More branches formed in Madras and Pondicherry functioned too. The ‘HSBC’ was started in 1869, Bengal. The ‘Oudh Commercial Bank’ started in 1881, Faizabad. The ‘Punjab National Bank’ started in 1894, Lahore. The ‘Catholic Syrian Bank’, ‘The South Indian Bank’, ‘Bank of India’, ‘Corporation Bank’, ‘Indian Bank’, ‘Bank of Baroda’, ‘Canara Bank’ and ‘Central Bank of India’ were a few banks which came up around the time of the Swadeshi movement. After independence, the ‘Reserve Bank Of India’ started in 1935 and nationalized in 1949. The ‘Allahabad Bank’, ‘Bank of Baroda’, ‘Bank of India’, ‘Bank of Maharashtra’, ‘Central Bank of India’, ‘Canara Bank’, ‘Dena Bank’, ‘Indian Bank’, ‘Indian Overseas Bank’, ‘Punjab National Bank’, ‘Syndicate Bank’, ‘UCO Bank’, ‘Union Bank of India’, ‘United Bank of India’ were nationalized in 1969. The Punjab and Sind Bank’, ‘Vijaya Bank’, ‘Oriental Bank of India’, ‘Corporation Bank’, Andhra Bank’ nationalized in 1980. Liberalization took place by the government in the 1990s. The private banks also included the ‘Global Trust Bank’, ‘IndusInd Bank’, ‘UTI Bank’, ‘ICICI Bank’, and ‘HDFC Bank’.

As per RBI Act 1934: the Reserve Bank of India is the central bank of India. Reserve Bank of India regulates all different types of Banks in India.

i) The First bank was “The Bank of Hindostan” in the banking history which was established in the year 1770 in Calcutta by “Alexander and Company” which was a European company.
ii) In the year 1806 Bank of Calcutta was established which was renamed in the year 1809 as Bank of Bengal.
iii) In the year 1840 Bank of Bombay and in the year 1843 Bank of Madras were established.
iv) In the year 1921, The Imperial Bank of India came into existence by the amalgamation of all three presidency banks (Bank of Bengal, Bank of Bombay, and Bank of Madras).
v) In the year 1865 India’s oldest first commercial & joint-stock Bank “Allahabad Bank” was established.
vi) In the year 1894 Punjab National Bank was founded in Lahore, Pakistan.
vii) After independence on 1 July 1955, the imperial bank of India was nationalized and renamed as State Bank of India as per SBI Act 1955.
viii) In the year 1975, the Regional Rural Banks were established.
ix) In the year 1991, post-liberalization, the concept of a new generation private bank was introduced.
x) In the year 2013, The RBI introduced the modern generation of private banks that is Small finance banks and Payments banks.

3.2. DIFFERENCE BETWEEN PRIVATE SECTOR AND PUBLIC SECTOR

a) Public Sector: Governments including government ministries and agencies, together with government-funded institutions, such as hospitals and prison services in those countries; Certain Confidential Information Contained In This Document, Marked By [***], Has Been Omitted Because It Is Both (I) Not Material And (Ii) Is The Type That The Registrant Treats As Private or Confidential. NGOs including those recognized by the applicable local government authority as well as UN-related organizations working for or in those countries, including the International Organization for Migration and UNICEF; Not-for-profit organizations including Medecins Sans Frontiers, Save-the-Children, OXFAM and the International Committee of the Red Cross; Public private partnerships that have agreed to public, not-for-profit, pricing, like the Initiative for Promoting Affordable and Quality TB Tests (IPAQT), or other collaborations or institutions bringing WHO-approved tests at affordable prices to patients in the private sector; and • Not-for-profit funding mechanisms including GAVI, GDF, UNITAID, UNFPA, PEPFAR, USAID, Global Fund, etc. (including entities funded by such mechanisms on a not-for-profit basis) and agencies based outside of an applicable country but who are supporting implementation locally in an applicable country, including the USA-CDC and The Union.

b) Private Sector: The private sector is the segment of a national economy that is owned, controlled, and managed by private individuals or enterprises. The private sector has a goal of making money and employs more workers than the public sector. A private sector organization is created by forming a new enterprise or privatizing a public sector organization. A large private sector corporation may be privately or publicly traded. Businesses in the private sector drive down prices for goods and services while competing for consumers' money; in theory, customers do not want to pay more for something when they can buy the same item elsewhere at a lower cost. In most free economies, the private sector makes up a big portion of the economy, as opposed to nations that have more state control over their economies, which have a larger public sector. For example, the United States has a strong private sector because it has a free economy, while China, where the state controls many of its corporations, has a larger public sector. The private sector is a very diverse sector and makes up a big part of many economies. It is based on many different individuals, partnerships, and groups. The entities that form the private sector include:Sole proprietorships, Partnerships, Small and mid-sized businesses, Large corporations and multinationals, Professional and trade associations. Trade unions. Even though the state may control the private sector, the government does legally regulate it. Any business or corporate entity operating in that country must operate under the laws

The private sector employs workers through individual business owners, corporations or other non-government agencies. Jobs include those in manufacturing, financial services, professions, hospitality, or other non-government positions. Workers are paid with part of the company's profits. Private sector workers tend to have more pay increases, more career choices, greater opportunities for promotions, less job security, and less comprehensive benefit plans than public sector workers. Working in a more competitive marketplace often means longer hours in a more demanding environment than working for the government.

i. The public sector employs workers through the federal, state or local government. Typical civil service jobs are in healthcare, teaching, emergency services, armed forces, and various regulatory and administrative agencies. Workers are paid through a portion of the government's tax dollars. Public sector workers tend to have more comprehensive benefit plans and more job security than private sector workers; once a probationary period concludes, many government positions become permanent appointments. Moving among public sector positions while retaining the same benefits, holiday entitlements, and sick pay is relatively easy while receiving pay increases and promotions is difficult. Working with a public agency provides a more stable work environment free of market pressures, unlike working in the private sector. The Bureau of Labor Statistics tracks and reports both private and public employment for the United States.

ii. A vast chronicle of banking history describes that people were banking on the concept of the barter system. Actually, that was not banking, that was simply a combination of need, demand, and supply. The organized banking system in India began in the late 18th century. As per the history of banking in India, the banking system was introduced by Europeans. Alexander and company was the first European company that introduced the banking system in India but over a period of time, different types of banks were introduced in India as per the need.

3.3. DIFFERENCE BETWEEN SCHEDULED BANKS AND NON-SCHEDULED BANKS

a) Scheduled Bank: Scheduled banks are banks that are listed in the 2nd schedule of the Reserve Bank of India Act, 1934. The bank's paid-up capital and raised funds must be at least Rs5 lakh to qualify as a scheduled bank. Scheduled banks are liable for low-interest loans from the Reserve Bank of India and membership in clearinghouses. They must, however, meet certain requirements, such as maintaining an average daily CRR (Cash Reserve Ratio) balance with the central bank at the rates set by it.

b) Scheduled Commercial Banks can be divided into: Scheduled Commercial Public Sector Banks**;** SBI and its associates Scheduled Commercial, Private Sector Banks ; Old Private Banks ; New Private Sector Banks ; Scheduled Foreign Banks in India. The benefits enjoyed by scheduled banks are often denied to non-scheduled banks. These banks have certain privileges and benefits, such as: 1) The ability to obtain a refinancing facility from the central bank.; 2) Access to currency storage facilities.; 3) Membership in the clearinghouse is automatic.

c) To be considered a scheduled bank, a bank must meet the following requirements: A total of Rs. 5 lakh in paid-up capital and reserves are needed. The bank must demonstrate to the central bank that its operations do not jeopardize depositors' interests. The bank must be a company, not a single owner or partnership company. Best FD Interest Rate: This Popular Bank Offers Citizens 8.80% Interest Rates Senior Citizen Fixed Deposit- 5 Banks Offering 8% Interest Rate,

3.3.1.Non-Scheduled Banks: Non-scheduled banks, by definition, are those that do not adhere to the RBI's regulations. They are not mentioned in the Second Schedule of the RBI Act, 1934, and are therefore deemed incapable of serving and protecting depositors' interests. Non-scheduled banks must also meet the cash reserve requirement, but not with reserve banks, but with themselves. They are generally smaller in size and have a range of influence that is somewhat narrow. They are risky to do business with due to their financial limitations. The reserve capital of these banks is less than 5 lakh rupees. There are 11 Non-Scheduled State Cooperative Banks as described by RBI.

Furthermore, 1500 Non-Scheduled Urban Co-operative Banks as described by RBI. This list is provided on the given weblink :1 Akhand Anand Co-Operative Bank Ltd 2 Alavi Co-Op Bank Ltd 3 Amarnath Co-operative Bank Ltd 4 Amod Nagrik Sahakari Bank Ltd 5 Amreli Nagrik Sahakari. Except in emergencies, non-scheduled banks are not eligible for Reserve Bank financial assistance. Non-schedule banks are often denied the benefits enjoyed by scheduled banks. They are also not eligible to be a member of a clearinghouse. As a result, unscheduled banks cannot facilitate interbank financial transactions and the clearance of cheques Higher Investment Limit In Saving Schemes Aimed At Benefiting Senior Citizens, Middle Class:

3.3.2. Major Difference between Scheduled Banks and Non-Scheduled Banks

	Scheduled bank	Non-scheduled banks
Paid-up Capital	A Scheduled bank is a banking company with a paid-up capital of Rs. 5 lakhs or more.	Non-scheduled banks, on the other hand, are those that are unable to comply with the RBI's requirements
Second Schedule	Scheduled banks are those regulated by the Reserve Bank's second schedule,	non-scheduled banks are those not bound by the Reserve Bank's second schedule
Periodic Returns	The Reserve Bank requires scheduled banks to present or send periodic returns.	Non-scheduled banks, on the other hand, are not required to submit periodic returns to the central bank.
Flexibility	The Reserve Banks will lend to scheduled banks.	Non-scheduled banks, on the other hand, do not have this flexibility. They'll only be able to do that with the help of other eager banks or only in case of emergency, RBI will help.
Clearinghouse	Scheduled banks are qualified to enroll in the clearinghouse	Non-scheduled banks are not qualified to enroll in the clearinghouse

The RBI allows Scheduled Banks to raise debts and loans at bank rates. Scheduled Banks All commercial banks, including nationalized, international, cooperative, and regional rural banks, fall under scheduled banks. A Scheduled bank is a banking company with a paid-up capital of Rs. 5 lakhs or more. Non-scheduled banks, on the other hand, are those that are unable to comply with the RBI's requirements. Scheduled banks are those regulated by the Reserve Bank's second schedule, while non-scheduled banks are those not bound by the Reserve Bank's second schedule. There are now a plethora of banks providing various services and catering to the needs of residents. There are different types of banks in India, which are regulated by the Reserve Bank of India, also known as the Central Bank of India. There are two types of banks: scheduled and non-scheduled banks, in addition to public and private banks.

These four local area banks fall under Non- Schedule Banks: 1. Coastal Local Area Bank Ltd - Vijayawada (Andhra Pradesh) 2. Capital Local Area Bank Ltd - Phagwara (Punjab) 3. Krishna Bhima Samruddhi Local Area Bank Ltd, Mahbubnagar (Andhra Pradesh) 4. Subhadra Local Area Bank Ltd., Kolhapur (Maharashtra).

3.3.3. Comparing Scheduled Banks and Non-Scheduled Banks

	Scheduled Banks	Non-Scheduled Banks
Second Schedule	They are listed in the second schedule.	Banks are not mentioned in the second schedule.
Meaning	A Scheduled bank is a banking company with a paid-up capital of Rs. 5 lakhs or more.	Non-scheduled banks, on the other hand, are those that are unable to comply with the RBI's requirements.
Cash Reserve Ratio	Reserve Bank of India.	They maintain with themselves
Borrowing	They are authorized to borrow funds from the Reserve Bank of India.	They are not authorized to borrow money from the Reserve Bank of India.

Examples	Commercial Banks, Private, and Public sector Banks	Local banks, State Cooperative Banks
Risk	They are financially stable and are unlikely to hurt the rights of the depositors.	These banks are riskier to do business.
Returns	They are required to file their returns on a periodic basis.	There is no such clause.
Membership	They can apply to join the clearinghouse	Are not eligible for membership in the clearinghouse

3.4. DIFFERENT TYPES OF BANKS IN INDIA (CLASSIFICATION OF BANKS)

Indian Banking Sector: The process of modern banking in India began in the late 18th century. The oldest profit-oriented bank is the 'Bank of Calcutta' started in 1806 and is presently known as the 'State Bank Of India'. Currently, there are 34 banks in India, out of which 12 are public sector banks and 22 are private sector banks. Banks have helped boost the economic development of the country and have encouraged a culture of saving amongst the people of the country. Let us learn about the various Types of Banks in India. Before studying the classification of banks in India first we should understand the bank. Banks are financial institutions that perform deposits and lending of money. There are various types of banks in India and each is responsible to perform different functions as per the formation and guidance of RBI, which reflects that India is a mixed economy.

3.4.1. Types of Banks in India: There are several types of banks in India that are broadly divided into 2 categories i.e. Scheduled Banks and Non – Scheduled Banks. The banking system is a core pillar of any nation's economy. For that, each country has a central bank that regulates the banking system by controlling all banks in that country. 1) Central Bank (Reserve Bank of India) 2) Scheduled Banks: a) Scheduled Commercial banks: i. Public Sector Banks, ii. Private Sector Banks, iii. Foreign Banks, iv. Regional Rural Banks, b) .Co-operative banks, c) Small finance banks , d) Payments banks, e) Local Area Banks, f) Specialized Banks.3) Nom Scheduled Banks

3.4.1. Central Bank (Reserve Bank of India): A chief bank that keeps a check on and synchronizes with all the other banks in a particular country is known as the Central Bank of the country. In India, the post of the Central Bank is that of the 'Reserve Bank of India' (RBI). The RBI is also known as the 'government's bank' or the 'banker's bank'. The RBI is responsible for regulating and guiding other banks in the country. It emanates the currency of the country i.e the Indian Rupee. It executes and carries out financial and monetary strategies, approaches, and determining policies. The RBI overlooks the pecuniary system of the country by handling the finances. It is also responsible for foreign exchange. All of these functions always take place under the supervision of the government of the country. Classification of Banks starts from the central bank of India i.e. Reserve Bank of India. The Reserve Bank of India is a regulatory body under the Ministry of Finance, Government of India. The central bank acts as the Government's Bank. In other words, the Reserve Bank of India may also be known as the **banker's bank** as it provides assistance to the other banks of the country.

3.4.1.a) Functions of the Reserve Bank of India(Central Bank): Given below are the functions of the Reserve Bank of India:

i. Financial Supervision,
ii. Regulator and supervisor of the financial system,
iii. Issue of currency,
iv. Regulator of the Banking system,
v. Banker and debt manager to government,
vi. Banker's Bank,
vii. Implementing the monetary policies,
viii. Custodian to Foreign exchange
ix. Monitoring of all different types of banks in India

3.5. SCHEDULED BANKS: FUNCTIONS OF CENTRAL BANK

Scheduled Banks are the banks that are listed in the second schedule of the RBI Act, 1934 Section 2(e). In the second schedule, only those banks are get listed that satisfy the criteria of RBI Act 1934, Section 42. Scheduled Banks have to maintain a paid-up capital of Rs. 5 lakhs and above along with the average daily Cash Reserve Ratio balance with the Reserve Bank of India at a prescribed rate. The RBI allows scheduled Banks to raise debts and loans at bank rates. It is one of the type of banks in India which constitute those banks, which have been included in the second schedule of Reserve Bank of India(RBI) Act 1934. It basically comprises commercial banks and cooperative banks. Commercial Banks primarily works on a profit basis and is engaged in the business of accepting deposits for the purpose of giving loans. Scheduled bank classification in India into:

Scheduled banks classification: a) Scheduled Commercial banks: i. Public Sector Banks, ii. Private Sector Banks, iii. Foreign Banks, iv. Regional Rural Banks, b) .Co-operative banks, c) Small finance banks , d) Payments banks, e) Local Area Banks, f) Specialized Banks.

3.5.1. Scheduled commercial banks classification: The scheduled commercial banks can further divided into **four categories**. Type of banks falling under the scheduled commercial banks are public sector banks, private sector banks, foreign banks and Regional rural banks. Bank Classification in India starts with scheduled banks. Such banks operate under the Banking Companies Act of 1956. These are often run by either the government or any private firm. The major aim of such banks is to earn maximum profit through their commercial policies. The deposit amount by its users acts as a major resource of its reserve. Concessional interest fares are only offered when directed by the CBI. Commercial banks is one the major type of banks which are registered under the banking companies act 1956. The main objective of these banks is to earn the profit. The primary source of funds of the commercial banks is public deposits.These banks are divided into three categories such as i. Public Sector Banks, ii. Private Sector Banks, iii. Foreign Banks, iv. Regional Rural Banks, These are appropriate for operation in both urban and rural areas. At present, there are 170 scheduled commercial banks in the country, which includes 91 regional rural banks (RRBs), 19 nationalised banks, 8 banks in State Bank of India group and the Industrial Development Bank of India Limited (IDBI Ltd).Besides, there are only four non-scheduled commercial banks in the country.

i) Public Sector Banks- These are those entities which are owned by government having more than 51% stake in the capital. The denominating shareholder is either the government or the central bank of the country.
ii) Private Sector Banks: Private Banks are those entities which are owned by private individuals/institutions and these are registered under the companies act 1956 as limited companies. The denominating shareholder is either an individual, some private organization, or a selected group of individuals.
iii) Foreign Banks: Foreign banks are also registered banks which are situated out of their home country and their branches are located in other countries. Foreign banks are required to follow the rules and regulation of both home country and host country. There are currently 45 foreign sector banks in India. Such banks have their head offices and main operating systems in a foreign country with their branches in India.
iv) Regional Rural Banks: Regional Rural Banks or RRBs are government banks operating at regional level in different states of India Operating under the Regional Rural Bank Act of 1976, these banks started in 1975. These banks aim at the development of rural and agricultural areas with the help of concessional loan offerings. The establishment of 196 has taken place in between 1987 – 2005. The ownership of these banks belong 50% to the national government, 15% to the state government, and 35% to the commercial bank. From 2005 onwards, the merging of these banks took place then by the government due to which the number reduced to 86.
These are designed to cater the needs of the rural area people. They were established on the recommendation of Narshimhan committee. After the legislation of the Regional Rural Banks Act, 1976, the first Regional Rural Bank “Prathama Grameen Bank” at Moradabad (U.P) was set up on October 2, 1975 which was sponsored by Syndidcate Bank with Rs 5 crore as initial capital. Regional Rural Banks are owned by three entities: Central Government with a share of 50%. State Government with a share of 15% and Sponsor Bank with a share of 35% (Any commercial bank can sponsor the regional rural banks).
a) ***Functions of Regional Rural Banks:*** As we are studying the classification of banks in India. Regional Rural Bank is one of them. RRBs were established to serve rural India.

i. Regional Rural Banks were established under the provisions of an ordinance passed on 26 September 1975 and the RRB Act 1976 to provide sufficient banking and credit facility for agriculture and other rural sectors. As a result, five RRBs were set up on 2 October 1975 on the recommendations of the Narsimha Committee on Rural Credit.

ii. RRBs are joint ventures among the Central government (50%), the State government (15%), and Commercial Bank (35%). Authorized paid-up capital for RRBs is Rs 5 crores. These are also scheduled commercial banks but they are established with the main objective of providing credit to weaker sections of the society like agricultural labours, marginal farmers, and small enterprises. They usually operate at regional levels in different states of India and may have branches in selected urban areas as well. There are a total of 56 Regional Rural Banks in India.

iii. Functions of RRBs are decided by the sponsor bank with the consultation of NABARD.
iv. Providing banking and financial services to rural and semi-urban areas
v. Government operations like disbursement of wages of MGNREGA workers, distribution of pensions, etc.

vi. Para-Banking facilities like debit cards, locker facilities, etc.

3.5.1. b) List of Regional Rural Banks Functioning in India: Regional Rural Banks are the type of commercial banks which helps to bring the financial inclusion in the primary level of the nation. Currently there are 43 RRBs in India and each RRB is sponsored by Government of India along with State Government and Sponsor bank. Regional Rural Banks (RRBs) were set up under the provisions of 26 September 1975 ordinance and the RRB Act of 1976 to allocate banking and credit services for agriculture and other rural sectors.

Sr.No.	Name of Regional Rural Bank	Sponsor Bank	State
1	Andhra Pradesh Grameena Vikas Bank	State Bank of India	Telangana
2	Andhra Pragathi Grameena Bank	Canara Bank	Andhra Pradesh
3	Arunachal Pradesh Rural Bank	State Bank of India	Arunachal Pradesh
4	Aryavart Bank	Bank of India	Uttar Pradesh
5	Assam Gramin Vikash Bank	Punjab National Bank	Assam
6	Bangiya Gramin Vikash Bank	Punjab National Bank	West Bengal
7	Baroda Gujarat Gramin Bank	Bank of Baroda	Gujarat
8	Baroda Rajasthan Kshetriya Gramin Bank	Bank of Baroda	Rajasthan
9	Baroda UP Bank	Bank of Baroda	Uttar Pradesh
10	Chaitanya Godavari Grameena Bank	Union Bank of India	Andhra Pradesh
11	Chhattisgarh Rajya Gramin Bank	State Bank of India	Chhattisgarh
12	Dakshin Bihar Gramin Bank	Punjab National Bank	Bihar
13	Ellaquai Dehati Bank	State Bank of India	Jammu & Kashmir
14	Himachal Pradesh Gramin Bank	Punjab National Bank	Himachal Pradesh
15	J&K Grameen Bank	J&K Bank Ltd.	Jammu & Kashmir
16	Jharkhand Rajya Gramin Bank	State Bank of India	Jharkhand
17	Karnataka Gramin Bank	Canara Bank	Karnataka
18	Karnataka Vikas Grameena Bank	Canara Bank	Karnataka
19	Kerala Gramin Bank	Canara Bank	Kerala
20	Madhya Pradesh Gramin Bank	Bank of India	Madhya Pradesh
21	Madhyanchal Gramin Bank	State Bank of India	Madhya Pradesh
22	Maharashtra Gramin Bank	Bank of Maharashtra	Maharashtra
23	Manipur Rural Bank	Punjab National Bank	Manipur
24	Meghalaya Rural Bank	State Bank of India	Meghalaya
25	Mizoram Rural Bank	State Bank of India	Mizoram
26	Nagaland Rural Bank	State Bank of India	Nagaland

27	Odisha Gramya Bank	Indian Overseas Bank	Odisha
28	Paschim Banga Gramin Bank	UCO Bank	West Bengal
29	Prathama UP Gramin Bank	Punjab National Bank	Uttar Pradesh
30	Puduvai Bharthiar Grama Bank	Indian Bank	Puducherry
31	Punjab Gramin Bank	Punjab National Bank	Punjab
32	Rajasthan Marudhara Gramin Bank	State Bank of India	Rajasthan
33	Saptagiri Grameena Bank	Indian Bank	Andhra Pradesh
34	Sarva Haryana Gramin Bank	Punjab National Bank	Haryana
35	Saurashtra Gramin Bank	State Bank of India	Gujarat
36	Tamil Nadu Grama Bank	Indian Bank	Tamil Nadu
37	Telangana Grameena Bank	State Bank of India	Telangana
38	Tripura Gramin Bank	Punjab National Bank	Tripura
39	Utkal Grameen Bank	State Bank of India	Odisha
40	Uttar Banga Kshetriya Gramin Bank	Central Bank of India	West Bengal
41	Uttar Bihar Gramin Bank	Central Bank of India	Bihar
42	Uttarakhand Gramin Bank	State Bank of India	Uttarakhand
43	Vidharbha Konkan Gramin Bank	Bank of India	Maharashtra

3.6. COOPERATIVE BANKS

Cooperative banks are small-sized financial institutions that are structured on a cooperation basis, established under the Co-operative Societies Act of different states and are regulated by the Reserve Bank of India (RBI). All cooperative banks in India are owned by their customers or members who are farmers, small traders and others. Cooperative banks work on the principle of "no profit, no loss". The objectives of cooperative banks are to provide different types of banking services like deposits and granting loans, protecting the poor people from the local money lenders by providing loans at low rates, like farmers, poor people, small businesses, local small industries, small funds for self-employment in urban and rural areas, major finance to agriculture-based activities like farming, horticulture, livestock and hatcheries.

i) Urban Cooperative Banks: Urban cooperative banks provide services to urban and rural areas. Urban cooperatives banks raise their working capital from share capital contributed by cooperative societies, deposits, borrowings and other sources.

ii) State Cooperative Banks: State cooperative banks are state-owned cooperative banks. State cooperative banks also raise their working capital from share capital contributed by cooperative societies, deposits, borrowings and other sources. State cooperative banks manage the urban cooperatives banks by accepting deposits and granting loans. Urban cooperative banks are not allowed to accept surplus cash from each other. They route the cash flow through state cooperative banks. Such Cooperative Banks operate under the state government's act. The main objective of these banks is to ensure the social well – being of the public. This is done by offering loans that are open to concession based on user comfort. These have a 3 level format:

Level 1: The state-level cooperative banks include The RBI, government, and NABARD finance. Public distribution of money takes place. Concessional CRR, SLR charges also apply upon these banks. (CRR- 3%, SLR- 25%). The ownership belongs to the state government and the various members choose the major management.
Level 2: The district-level cooperative banks. These are set up to enhance development in the agricultural sectors of majorly the rural areas. But they also run non – agricultural cooperatives with other unions, etc. Each district has a district-level bank in India. These banks are together represented by a State Apex Central Co-operative bank for each state. The members indulge in multiple different professions. These banks get loans at an interest rate of 1% to 2% lower than the standard bank rate
Level 3: The rural or village level cooperative banks with their main focus on primary agriculture. NABARD is responsible for keeping a check on these banks. Primary Agricultural Credit Societies (PACs) exist on this level which works on grassroots levels. This help provides short and middle term loans to their members and acts as a link between the higher financial institutions of the country and their members. As of March 2018, there were 96248 such banks in the country.

3.7. SMALL FINANCE BANKS

The small finance bank shall be registered under the Companies Act, 2013. It is licensed under section 22 of the Banking Regulation Act, 1949. The minimum paid-up capital required to set up a small finance bank is Rs.200 crore and it will be required to maintain a capital adequacy ratio of 15 percent of its risk-weighted assets. The promoters have to contribute an initial 40 percent of paid-up equity capital. According to FDI policy foreign investors can invest in small finance banks up to 74 percent of equity capital (49 percent from direct route and other from approval route). There was a huge gap in society regarding financial inclusion. In society, there was a huge section of the population who was unserved and underserved by the financial and banking services. For any developing and growing nation, it is very important to bring society into the mainstream of financial inclusion. For filling up the financial inclusion gap, RBI introduced a new generation of modern banks into the banking system. These are called Small Finance Banks.
The objectives of small finance banks are to provide financial inclusion services to small usiness enterprises, small and marginal farmers, micro and small industries and various other entities of the unorganized sector. On the recommendation of the Usha Thorat Committee, in the year 2014 RBI introduced and released the guidelines for small finance banks. RBI gave the small finance bank license to the NBFCs and Urban Co-operative Banks (UCBs),

3.7.1. Important RBI Guidelines and Features of Small Finance Banks:

i)The minimum paid-up equity capital for a small finance bank is Rs.200 crore at the time of commencement of business. Minimum paid-up capital of Rs. 200 crore is applicable for NBFCs who transiting to Small Finance Bank. But Urban Co-operative Banks (UCBs) that transiting to Small Finance Bank, the minimum paid-up equity capital of Rs. 100 Crores was decided at the time of commencement of business. Banks will have to increase the minimum paid-up equity capital to Rs. 200 crores within five years from the date of commencement of business.
ii) Small Finance Banks have to open at least 25 percent of their banking outlets in unbanked rural centers.
iii)The small finance bank will be required to use the words "Small Finance Bank" in its name in order to differentiate it from other banks.

iv) Small finance banks have to maintain a minimum capital adequacy ratio of 15 percent of their risk-weighted assets (RWA) on a continuous basis.
v) As per RBI guidelines, promoters shall hold a minimum of 40 percent of the paid-up equity capital of the bank, which shall be locked in for a period of five years from the date of commencement of business of the bank. The promoter's stake should be brought down up to 30 percent of the paid-up equity capital of the bank in 10 years and up to 15 percent of the paid-up equity capital of the bank in 15 years from the date of commencement of business of the bank.
vi) Foreign Direct Investment (FDI) in small finance banks is applicable as per the Foreign Direct Investment (FDI) policy for private sector banks.
vii) .Small finance banks have to maintain Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR) as per RBI guidelines.
viii) Small finance banks can serve financial services like mutual funds, insurance products, pension products, etc but with the prior approval of RBI.
ix) Small finance banks can transform into full-fledged banking (universal bank) units after fulfilling the norms set by RBI.
x) To fulfilling the objectives of RBI for which small finance banks are set up, banks are required to extend 75 percent of their Adjusted Net Bank Credit (ANBC) to the priority sector lending (PSL).
xi) At least 50 percent of its loan portfolio should constitute loans and advances of up to Rs.25 lakh. The criteria for the upper limit of Rs.25 lakh shall be borrower wise.
xii) The small finance bank cannot be a Business Correspondent (BC) for another bank. it can have its own Business Correspondent (BC) network.
xiii) Small finance banks come under RBI's Banking Ombudsman Scheme, 2006.

Regulated and controlled by the national government of the country. Responsible for offering finances and loans to minor businesses and trades such as farming or the poor unorganized sector. Name of some Small Finance Banks:

i. AU Small Finance Bank ,
ii. Capital Small Finance Bank,
iii. ESAF Small Finance Bank ,
iv. Equitas Small Finance Bank ,
v. Fincare Small Finance Bank,
vi. Utkarsh Small Finance Bank ,
vii. Jana Small Finance Bank ,
viii. Suryoday Small Finance Bank ,
ix. Northeast Small Finance Bank ,
x. Ujjivan Small Finance Bank

3.8. PAYMENT BANKS

The introduction of payment banks to the Indian banking system was a revolutionary step taken by RBI for financial inclusion for the benefit of small businesses, low-income households and migrant labourers. In the year 2013 RBI formed a committee for bringing the unserved and underserved sections of the society into the mainstream of financial inclusion. The committee was headed by Mr. Nachiket Mor. On the recommendation of the Nachiket Mor Committee, in the year 2014 RBI released the guidelines for payment banks. Finally, in the year 2015 RBI granted banking licenses under section 22 (1) of the banking regulation act, 1949. Initially, RBI issued payment bank licenses to 11 entities to launch payment banks but out of these 3 entities surrendered the license. Payments bank is a new form of bank-created under the purview of the Reserve Bank of India (RBI). Payments banks can accept a limited deposit of ₹200,000 per customer and earlier it was 100,000 . These banks cannot lend loans and issue credit cards but they can offer services such as net banking, ATM cards, debit banks and Mobile Banking. Their funds are invested in government securities. This concept of payment banks was formulated under the Nachiket Mor Commitee. India currently has 6 Payment Banks namely, Airtel Payment Bank, India Post Payment Bank, Fino, Paytm Payment Bank, NSDL Payment Bank and Jio Payment Bank

3.8. i. Important RBI Guidelines and Features of Payment Banks:

Payment banks are scheduled banks like commercial banks. Payment banks are allowed to serve all banking services to the customers like commercial banks but with certain restrictions.

i. Payment banks can open savings and current accounts. Payment banks pay interest on saving account deposits as other commercial banks pay.

ii. All types of current accounts can be opened: individual current account, a sole proprietorship firm, partnership firm, limited liability partnership firm (LLP), private limited company, public limited company, trust, society, an association of persons(AOP), Hindu undivided family(HUF)

iii. As per the RBI guidelines, initially at the time of license payment banks could hold a maximum day-end balance of ₹ 1 lakh per customer. On April 8, 2021, RBI had doubled the limit, the maximum balance a customer can hold at end of the day in a Payment Bank is ₹2 lakh.

If the customer's deposit with a payment bank at the end of the day exceeds Rs 2 lakh, an auto sweep arrangement allows the payment bank to open a fixed deposit account with another commercial bank on behalf of the customer to park the surplus amount in form of fixed deposit.This day-end balance limit is imposed on the sum of your wallet balance, savings account balance and current account balance. The total balance in your Current Account is the sum of your Current Account balance and FD invested.

iv. Payment banks can issue ATM or debit cards to their customers but cannot issue a credit cards.

v. As per the RBI guidelines, Payment Banks cannot offer loans/credits facilities to the customers.

vi. Payment bank customers are allowed to make payments using IMPS, NEFT, RTGS, and UPI.

vii. RBI allows payment banks to issue chequebook.

viii. Payment banks are allowed to transfer payments through any channels like branches, Automated Teller Machines (ATM), business correspondents etc.

ix. RBI allows payment bank's current account customers to make personal payments and receive remittances from the cross border in the current accounts.

x. As per RBI, payment banks are strictly restricted to accept deposits from Non-Resident Indians (NRIs).

xi. RBI allows payment banks to work as a partner with other commercial banks and also can sell mutual funds, pension products, and insurance products.

xii. Payment banks provide internet and mobile banking services to customers.

3.8 (ii). List of banks who got payment banks license.

Payment Bank	Year of Establishment	Headquarters	Current status
Cholamandalam Distribution Services	2017		surrendered the license
Sun Pharmaceuticals	2017		surrendered the license
Tech Mahindra	2017		surrendered the license
Aditya Birla Payments Bank	2018		defunct payments banks in 2019
Vodafone m-pesa Limited	2017		defunct payments banks in 2019
Airtel payments Banks	2017	New Delhi, Delhi	Operational
India Posts payments banks	2018	New Delhi, Delhi	Operational
Fino payments banks	2017	Mumbai, Maharashtra	Operational
Jio payments banks	2018	Mumbai, Maharashtra	Operational
Paytm payments banks	2017	Noida, Uttar Pradesh	Operational
NSDL Payments Banks	2018	Mumbai, Maharashtra	Operational

Payment banks are scheduled banks like commercial banks. As per RBI guidelines, payment banks have to fulfill all the necessary parameters for a banking license like: The minimum paid-up equity capital of Rs. 100 Crores was decided for payment banks. Banks have to maintain **net demand and time liability of 100 crores** and above to set up a payment bank. Payment banks have to maintain the Cash Reserve Ratio (CRR) with RBI as other commercial banks do. This latest introduction to the banking format design took place by the RBI. The maximum deposit accepted in these banks is that of Rs.100000. There is no facility of loans or credit cards available in such banks. Net, online, mobile, ATM, and debit card banking can take place via.

3.9. LOCAL AREA BANKS (LAB)

Operating under the Companies Act, 1956 these banks originated in the year 1996. These are commercially driven banks with the aim of earning profit. These are run by private firms. Currently, in India, there are 4 Local Area Banks located in the southern part of India. Local area banks are the type of non scheduled banks. These banks are governed by the companies act 1956. The Local area banks are introduced only around 1996 as the main objective to run only in local areas to generate profits. Commercial private sector banks manage these banks. However, not many local area banks are there in India. Some of them include :

i. Coastal Local Area Bank in Andhra Pradesh,
ii. Subhadra Local area bank in Kolhapur,
iii. Capital Local area bank in Punjab, and Krishna

3.10. SPECIALIZED BANKS

Specialized Banks are one of the category of banks in India which are setup for a special purpose. There are certain specialised banks which plays a very crucial role in the banking system. Banks which started for determined purposes are Specialized Banks. The 'Export and Import' (EXIM) Bank is a part of the specialized banks. Export and import finances take place and loans occur via these banks. Commercial and monetary responsibilities regarding rural artworks, handicrafts, villages, and agricultural development often take place by the 'National Bank for Agricultural & Rural Development' (NABARD). The Small Industries Development Bank of India (SIDBI) offers loans for small scale industries and also upgrades them in terms of technology and equipment. These are responsible for the economic and industrial development of the country.
NABARD- National Bank for Agriculture & Rural Development is the full form of NABARD. This bank was formed for the development of agriculture sector in our country and is still doing the same.
EXIM- Export Import Bank of India was formed to promote domestic industries so that they can export their products. This bank grant loans. The primary objective of EXIM Bank is to provide financial assistance to exporters and importers.
SIDBI- Small Industrial Development Bank of India is one the major financial institution which provides financial assistance to micro industries for their expansion and development.

3.11. SUMMARY

There are different types of banks in India, which are regulated by the Reserve Bank of India, also known as the Central Bank of India. There are two types of banks: scheduled and non-scheduled banks, in addition to public and private banks. The banking system is a core pillar of any nation's economy. For that, each country has a central bank that regulates the banking system by controlling all banks in that country. 1) Central Bank (Reserve Bank of India) 2) Scheduled Banks: a) Scheduled Commercial banks: i. Public Sector Banks, ii. Private Sector Banks, iii. Foreign Banks, iv. Regional Rural Banks, b) .Co-operative banks, c) Small finance banks , d) Payments banks, e) Local Area Banks, f) Specialized Banks.3) Nom Scheduled Banks The said above information increases awareness of the history and types of banks present in India. It also boosts preparations for competitive exams. Many well-known banks are also classified into the given categories. This article also explains how various institutions link to each other and where their services are best available. This encourages people to sensibly invest in their choice of bank by granting them enough knowledge on how each bank works.

3.12. TECHNICAL TERMS

Public Sector Banks: Public Sector Banks means State Bank of India and nationalised banks. Public Sector Banks means a commercial bank in which the Government of India owns at least fifty-one percent (51%) of the equity or has the ability to control its management and policies. Public Sector Banks means, the State Bank of India, the Subsidiary Banks and the corresponding new banks referred to in Section 45(1) of the Reserve Bank of India Act. 1934 (2 of 1934).

Private Sector Banks: Private banking consists of personalized financial services and products offered to the high-net-worth individual (HNWI) clients of a retail bank or other financial institution. It includes a wide range of wealth management services, and all provided under one roof. Services include investing and portfolio management.

Payments banks: They are registered under the Companies Act 2013 but are governed by a host of legislations such as Banking Regulation Act, 1949; RBI Act, 1934; Foreign Exchange Management Act, 1999, Payment and Settlement Systems Act, 2007 and the like. India currently has 6 Payment Banks namely, Airtel Payment Bank, India Post Payment Bank, Fino, Paytm Payment Bank, NSDL Payment Bank and Jio Payment Bank.

3.13. SELF ASSESSMENT QUESTIONS

1. Discuss about History of the Indian Banking System
2. What are the Differences between Private and Public Sector?
3. What are the Difference between Scheduled Banks and Non-Scheduled Banks
4. Explain about Different Types of Banks in India
5. Explain the Functions of Central Bank & Specialized Banks in India.
6. What are the levels of Cooperative Banks in India?
7. What is the importance of Small Finance Banks in India?
8. What is the role of Payment Banks & Local Area Banks in India?

3.14. SUGGESTED READINGS

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LESSON - 4
COMMERCIAL BANKING SYSTEM IN INDIA

AIMS AND OBJECTIVES

After studying this lesson student should be able to

- Know the Commercial Banking System in India
- Understand the features & Functions of Commercial Banks in India
- Explain the Role and Importance of Commercial Banks
- Classified the Different Types of Commercial Banks in India

STRUCTURE

4.1. INTRODUCTION

Commercial banks are regulated by the Banking Regulation Act 1949. Commercial Banks operate with a head office and network of branch offices spread throughout the country. Commercial banks are one of the types of banks in India. The main functions of commercial banks are: to accept deposits from the public and grant loans to individuals, traders, and industries at a defined rate of interest in order to earn profit and to offer other basic financial services to business organizations. They also provide other services like remittance of funds, locker facility, collection of cheques, issue letter of credit, bank guarantees, business loans, cash credit limit facility, overdraft facilities, purchase and sale of bonds and securities, etc.

A commercial bank is a financial intermediary that serves businesses by providing essential liquidity functions within an economy via various products and services. The institution accepts and manages deposits to earn fee income and as a low-cost source of funds. Funds can generate interest income via credit creation and offering credit facilities. Deposit acceptance and credit creation are two dominant revenue sources for commercial banks, with clients spanning a broad section of the economy. Typically, a commercial bank serves businesses with less complex needs than those supported by corporate banking and investment banking specialists. Typically, a commercial bank serves businesses with less complex needs than those supported by corporate banking and investment banking specialists. Commercial banks offer basic services of banking to the public including individual customers as well as small and medium-sized businesses. Money is made by banks by charging for services and fees. The fees depend on the products given such as overdraft fees, fees for safe deposit boxes, late fees, etc. Banks earn money by giving out loans and for that purpose they use funds from customer deposits. They charge higher interest rates on loans they give out and comparatively less rate of interest on the amount they get as deposits from their customers. For e.g., a bank may provide a 0.30 per cent rate of interest on savings account to its customers but charges a 4.8 per cent rate of interest annually for home loans. Generally, commercial banks are situated in buildings where their customers come for using ATM machines and other banker window facilities. As internet technology has risen in recent years, most banks allow customers to do most services online. People can now make money transfers, deposits or make payments for bills online.

4.1.1. Commercial Banks vs. Investment Banks

Both commercial and investment banks provide important services and play key roles in the economy. For much of the 20th century, these two branches of the banking industry were generally kept separate from one another in the U.S., thanks to the Glass-Steagall Act of 1933, which was passed during the Great Depression. It was largely repealed by the Gramm-Leach-Bliley Act of 1999, allowing for the creation of financial holding companies that could have both commercial and investment bank subsidiaries. While commercial banks have traditionally provided services to individuals and businesses, investment banking offers banking services to large companies and institutional investors. They act as financial intermediaries, providing their clients with underwriting services, merger and acquisition (M&A) strategies, corporate reorganization services, and other types of brokerage services for institutional and high-net-worth individuals (HNWIs). While commercial banking clients include individual consumers and small businesses, investment banking clients include governments, hedge funds, other financial institutions, pension funds, and large companies. Some of the world's largest financial institutions are commercial banks or having commercial banking operations—many of which can be found in the United States. For instance, Chase Bank is the commercial banking unit of JPMorgan Chase. Headquartered in New York City, Chase Bank reported about $3.2 trillion in assets as of June 2021. Bank of America is the second-largest bank in the United States, with more than $2.35 trillion in assets and 66 million customers including both retail clients and small and mid-sized businesses.

4.2. FUNCTIONS OF COMMERCIAL BANKS

4.2. a) Primary functions are: Commercial banks accept various types of deposits from the public especially from its clients, including saving account deposits, recurring account deposits, and fixed deposits. These deposits are returned whenever the customer demands it or after a certain time period.

i. Commercial banks provide loans and advances of various forms, Such as [overdraft] facility, cash credit, bill discounting, money at call, etc. They also give demand and term loans to all types of clients against proper security. They also act as trustees for wills of their customers etc.

ii. The function of credit creation is generated on the basis of credit and payment intermediary. Commercial banks use the deposits they absorb to make loans. On the basis of check circulation and transfer settlement, the loans are converted into derivative deposits. To a certain extent, the derivative funds of several times the original deposits are increased, which greatly improves the driving force of commercial banks to serve the economic development.

4.2. b) Other functions of commercials banks: Along with core products and services, commercial banks perform several secondary functions. The secondary functions of commercial banks can be divided into agency functions and utility functions.

I. Agency functions include:

i. To collect and clear cheques, dividends, and interest warrant
ii. To make payments of rent, insurance premium
iii. To deal in foreign exchange transactions
iv. To purchase and sell securities
v. To act as the trustee, attorney, correspondent and executor
vi. To accept tax proceeds and tax returns

II. Utility functions include:

i. To provide safe deposit boxes to customers
ii. To provide money transfer facility
iii. To issue traveler's cheques
iv. To act as referees
v. To accept various bills for payment: phone bills, gas bills, water bills
vi. To provide various cards such as credit cards and debit cards

4.3. FINANCIAL SERVICES PROVIDED BY COMMERCIAL BANKS

As a financial intermediary, a commercial bank provides financial services to organizations of varying sizes, bringing together users (borrowers) and providers (depositors) of funds.

i. Deposit acceptance: Deposit-gathering is a necessary function of any commercial bank and is required to offer credit products and services at a lower cost than external financing. Gathering deposits is the key to generating an acceptable return on equity, tied to the growth of a commercial bank's credit portfolio and interest income.

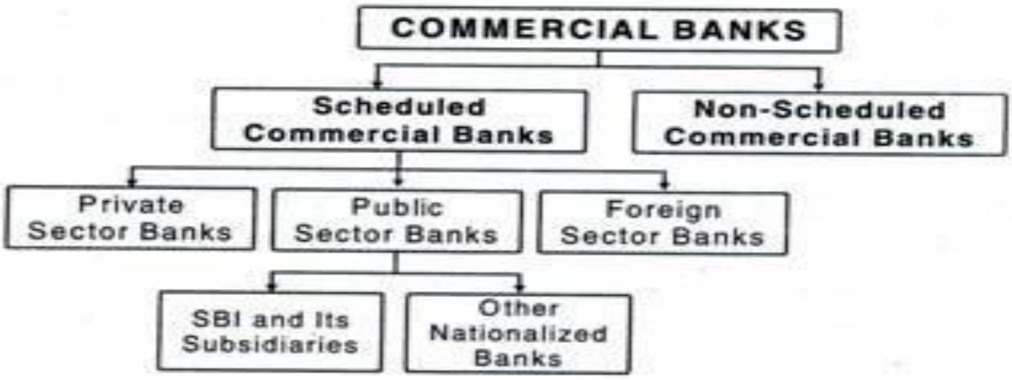
ii. Credit creation: Regulators set the minimum cash reserve a commercial bank must hold to support its deposit liabilities. Excess deposits may be used to create credit to lend via commercial loans and other credit products or lend to other institutions at the overnight rate. Credit creation is a critical function of a commercial bank. Interest is the highest percentage of revenue at commercial banks.

iii. Treasury and payments : To increase economies of scope and scale, as well as the share of wallet, commercial banks offer invoicing, collection, and also merchant (point-of-sale) solutions to support current asset requirements for businesses. Expenses paid via cheque, charge and credit cards, and electronic payments are offerings that support current liability requirements.

iv. Agency and advisory: Commercial banks also offer many agencies and advisory functions due to their privileged position as financial intermediaries. Advisory services to manage risks from business-to-business activities, supporting trade credit with global entities participating in import and export, or documenting the performance of cross-border services, are some examples in this category.

4.4. STRUCTURE OF COMMERCIAL BANKS IN INDIA

Commercial Banks are the financial institutions which are licensed by the Central Bank of the country, i.e., RBI, to perform essential banking functions including accepting deposits and offering Personal Loans and other lending options. The principal aim of the commercial banks in India is to earn profits, i.e., they engage in banking business to generate profits. Apart from individual customers, **commercial banks in India** deal with business entities as well offer several types of Short-Term and Long-Term Loans. The primary source of profit for the best Commercial Banks in India is the difference between interest rates charged from borrowers and interest rates offered to depositor. The commercial banks can be broadly classified under two heads:



A. Scheduled Banks: Scheduled Banks refer to those banks which have been included in the Second Schedule of Reserve Bank of India Act, 1934. In India, scheduled commercial banks are of three type**s:**

(i) Public Sector Banks: These banks are owned and controlled by the government. The main objective of these banks is to provide service to the society, not to make profits. State Bank of India, Bank of India, Punjab National Bank, Canada Bank and Corporation Bank are some examples of public sector banks. Public sector banks are of two types: (a) SBI and its subsidiaries; (b) Other nationalized banks

(ii) Private Sector Banks: It is a type of commercial banks where private individuals and businesses own a majority of the share capital. All private banks are recorded as companies with limited liability. Such as Housing Development Finance Corporation (HDFC) Bank, Industrial Credit and Investment Corporation of India (ICICI) Bank, Yes Bank, and more such banks. These banks are owned and controlled by private businessmen. Their main objective is to earn profits. ICICI Bank, HDFC Bank, IDBI Bank is some examples of private sector banks.

(iii) Foreign Banks: These banks are established in foreign countries and have branches in other countries. For instance, American Express Bank, Hong Kong and Shanghai Banking Corporation (HSBC), Standard & Chartered Bank, Citibank, and more such banks. These banks are owned and controlled by foreign promoters. Their number has grown rapidly since 1991, when the process of economic liberalization had started in India. Bank of America, American Express Bank, Standard Chartered Bank are examples of foreign banks.

B. Non-Scheduled Banks: Non-Scheduled banks refer to those banks which are not included in the Second Schedule of Reserve Bank of India Act, 1934.

4.5. LIST OF COMMERCIAL BANKS IN INDIA

Commercial banks are divided into: Public Sector Banks, Private Sector Banks, Regional Rural banks & Foreign Banks. Public Sector Banks: Classification of banks in India starts from public sector scheduled banks. Public sector banks are nationalized banks. In public sector banks, the majority of shares i.e. more than 50% are held by the Government of India. 14 private banks that accounted for 85% of bank deposits in the country at that time were nationalised on July 19, 1969. The net demand and time liability was Rs. 50 crore and above for all 14 banks. 6 private banks also nationalised in the year 1980 with a net demand and time liability of Rs. 200 crores and above. From time to time the government of India took the decision to restructure the banking system. In the year 2017, all associate banks along with Bhartiya Mahila Bank were merged with the State Bank of India. In the year 2019, Dena Bank and Vijaya Bank both merged with Bank of Baroda. And the recent merger was completed in the year 2021, in which 10 public sector banks were merged and formed 4 banks.

4.5.a. Public Sector Banks(nationalized banks) : There are a total of 12 nationalized banks in the country namely below:

Anchor Bank	Merged Banks	Head Quarter	Established Year
Bank of Baroda	Vijaya Bank, Dena Bank	Vadodara, Gujrat	1908
Bank of India		Mumbai	1906
Bank of Maharashtra		Pune	1935
Canara Bank	Syndicate Bank	Bengaluru, Karnataka	1906
Central Bank of India		Mumbai	1911
Indian Bank	Allahabad Bank	Chennai, Tamilnadu	1907
Indian Overseas Bank		Chennai, Tamilnadu	1937

Punjab and Sindh Bank		New Delhi	1908
Punjab National bank	Oriental Bank of Commerce, United Bank of India	Newdelhi	1894
State Bank of India	State Bank of Saurashtra, State Bank of Indore, State Bank of Bikaner and Jaipur, State Bank of Hyderabad, State Bank of Mysore, State Bank of Patiala, State Bank of Travancore, Bhartiya Mahila Bank	Mumbai	1955
UCO Bank		Kolkata	1943
Union Bank of India	Andra Bank, Corporation bank	Mumbai	1919

4.5.b. **Private Sector Banks:** i. Banks in which a major stake or equity is held by private shareholders. All the banking rules and regulations laid down by the RBI will be applicable to private sector banks as well. ii. When the economic reforms were taking place in the early nineties the role of private banks was recognized. iii. Financial sector reforms were set up in the year, 1991 under Shri M. Narasimham Committee. iv. From the year 1993 to the year, 2020 RBI issued banking licenses to different types of banks in India. v. In the year, 1993 the initial minimum paid-up capital was raised from ₹100 crores to ₹200 crores, which was required to be raised further to ₹300 crores within three years of commencement of business. vi. The objective of financial reforms and providing licenses to the private banks in the year,1991 was to bring competition and efficiency to the banking industry.

4.5. b. List of private-sector banks in India

Bank name	Established	Headquarter
Axis Bank	1993	Mumbai, Maharashtra
Bandhan Bank	2015	Kolkata
CSB Bank	1920	Thrissur, Kerala
City Union Bank	1904	Thanjavur, Tamilnadu
DCB Bank	1930	Mumbai, Maharashtra
Dhanlaxmi Bank	1927	Thrissur, Kerala
Federal Bank	1931	Kochi, Kerala
HDFC Bank	1994	Mumbai, Maharashtra
ICICI Bank	1994	Vadodara, Gujarat
IDBI Bank	1964	Mumbai, Maharashtra
IDFC First Bank	2015	Mumbai, Maharashtra
IndusInd Bank	1994	Mumbai, Maharashtra
Jammu & Kashmir Bank	1938	Srinagar, Jammu & Kashmir
Karnataka Bank	1924	Mangaluru, Karnataka
Karur Vysya Bank	1916	Karur, Tamil Nadu
Kotak Mahindra Bank	2003	Mumbai, Maharashtra
Nainital Bank	1922	Nainital, Uttarakhand
RBL Bank	1943	Mumbai, Maharashtra
South Indian Bank	1929	Thrissur, Kerala
Tamilnad Mercantile Bank	1921	Thoothukudi, Tamil Nadu
Yes Bank	2004	Mumbai, Maharashtra

4.5. c. Foreign Banks: Foreign banks are supposed to provide banking services to multinational clients, industries, corporates, etc. A bank that has to follow a dual banking regulation system in a country is known as a foreign bank. These banks follow the regulations of their home country as well as the country in which they are operating. Such types of banks in India have their headquarters in a foreign country but operate in India.

Foreign banks have presence in India with 2 models. Either through branches or Wholly Owned Subsidiaries. The initial minimum paid-up equity capital shall be 5 billion.

4.6. TOP 10 COMMERCIAL BANKS IN INDIA

India is one of the fastest-growing economies of the 21st century and is ranked amongst the top five economies globally. One of the biggest reasons behind this stupendous growth is the robust banking network that India possesses. As per the latest IMF (International Monetary Fund) and RBI (Reserve Bank of India) Data, India has the most extensive branch network for commercial banks in the world. The banking system in India presently includes more than 1.3 lakh bank branches with an almost equal number of urban as well as rural branches, i.e., 38% in urban areas, 34% in rural areas, and 28% in semi-urban areas. This extensive network of Commercial Banks in India enables every common citizen with easy access to the banking facilities, helping with the progress of the country.

4.6. a. List of Top 10 commercial banks in India: With numerous commercial banks offering their services in the country, you might be wondering about the best Commercial Banks in India. For your convenience and information, here is a list of the top 10 types of commercial bank in India.Top 10 commercial banks in India are the State Bank of India, ICICI Bank, HDFC Bank, Axis Bank, Bank of Baroda, Kotak Mahindra Bank, IndusInd Bank, Punjab National Bank, Bank of India, and Canara Bank.

4.6. 1. State Bank of India: State Bank of India is the biggest **commercial bank in India** with 24,000+ branches across various locations in India as well as 190+ overseas branches in 36 countries. SBI boasts of 25% share of the entire loans and deposits market in India along with 23% of market share in assets. SBI also features in the Fortune Global 500 list of biggest corporations in the world. Government of India holds 61.23% of the ownership of the bank as of March 2019.

Product	**Interest Rates**
SBI Personal Loan	9.60%
SBI Home Loan	6.70%
SBI Business Loan	11.20%
SBI Loan Against Property	6.65%

4.6.2. HDFC Bank: HDFC Bank is a leading private sector bank and is in the list of **top 5 commercial banks in India** right now. It started its operations in 1994. Presently, the bank boasts of 5,100+ branches across various cities in India. Thanks to its excellent customer service and innovative products, HDFC has won several awards over the years including the award for best bank in India in 2019 by FinanceAsia magazine. With 1,00,000+ employees and total market assets of more than 11,89,432 crores, HDFC Bank is indeed a leading name in the Indian banking sector.

Product	**Interest Rates**
HDFC Personal Loan	10.50%
HDFC Home Loan	6.70%

HDFC Business Loan	11.90%
HDFC Loan Against Property	8.00%

4.6.3. ICICI Bank: ICICI Bank is a prominent private sector Commercial Bank which was established in the year 1994. It is among the top **5 commercial banks** in India currently. At present, ICICI Bank has more than 4,800 branches and 14,000+ ATMs across various cities in India with a presence in 17 international locations. ICICI Bank employs 84,000+ employees and has annual revenue of more than Rs. 77,900 crores. The total market assets of the bank as of 2019 are Rs. 9,29,652 crores.

Product	Interest Rates
ICICI Personal Loan	10.50%
ICICI Home Loan	6.70%
ICICI Loan Against Property	8.35%

4.6.4. Kotak Mahindra Bank: Kotak Mahindra Bank is a premier private sector bank in India which began its operations in the year 2003. With total assets of more than Rs. 2.14 trillion, it is the second-largest private sector bank in India. Kotak Bank employs 33,000+ employees and has more than 1,300 branches across India. The annual revenue of the bank is more than Rs. 285 billion.

Product	Interest Rates
Kotak Mahindra Bank Personal Loan	10.25%
Kotak Mahindra Bank Home Loan	6.55%
Kotak Mahindra Bank Loan Against Property	7.25%
Kotak Mahindra Bank Business Loan	16.00%

4.6.5. Bank of Baroda: Bank of Baroda is a leading public sector bank of India and was founded in the year 1908. As of 2019, the bank has 9500+ branches and employs more than 85,000 personnel. It is India’s second-largest bank by market capitalisation, which as of March 2019, stands at Rs. 3.58 trillion. With the recent merger of Bank of Baroda, Dena Bank, and Vijaya Bank, the new entity is now the third-largest bank in India.

Product	Interest Rates
Bank of Baroda Personal Loan	10%
Bank of Baroda Home Loan	6.50%
Bank of Baroda Loan Against Property	8.15%
Bank of Baroda Business Loan	14.10%

4.6.6. Axis Bank: Axis Bank is the third-largest private sector bank of India which started its operations in 1993. It has an extensive network of 4,000+ branches and 11,800+ ATMs across India. The employee strength of the bank presently stands at 61,000+. As of March 2019, the total market capitalisation of Axis Bank is more than Rs. 1.31 trillion with total assets to the tune of Rs. 8.1 trillion.

Product	Interest Rates
Axis Bank Personal Loan	12%
Axis Bank Home Loan	6.75%
Axis Bank Loan Against Property	7.30%
Axis Bank Business Loan	14.25%

4.6.7. IndusInd Bank: IndusInd Bank, a leading private sector bank, started its operations in the year 1994 and presently operates 1,500+ branches and 2,400+ ATMs across all major cities of India. The employee strength of the bank is 25,000+ while the total assets are more than Rs. 178,648 crore.

Product	Interest Rates
IndusInd Bank Personal Loan	11.00%
IndusInd Bank Home Loan	6.70%

4.6.8. Punjab National Bank: Popularly known as PNB, this bank started its operations in the year 1894. Presently, it boasts of more than 110 million customers who are served through 7000+ branches and 10,600+ ATMs. PNB presently employs more than 70,000 personnel across India. The shareholding of the government in PNB is 75.4%. Total assets of the bank are Rs. 774,949 crores while the annual revenue is more than Rs. 58,600 crores.

Product	Interest Rates
PNB Personal Loan	8.95%
PNB Home Loan	6.75%

4.6.**9. Bank of India:** Bank of India is a leading public sector commercial bank which started its operations in the year 1906. Bank of India has an extensive network of 5,100+ branches across India with more than 48,000 employees. Bank of India has 56 branches located outside India as well. The total assets of the bank are to the tune of Rs. 6.3 trillion with the annual revenue being Rs. 462.6 billion.

Product	Interest Rates
Bank of India Personal Loan	10.35%
Bank of India Home Loan	6.50%

4.6.10. Canara Bank: Canara Bank was founded in the year 1906 and is presently one of the largest public-sector commercial banks in India. Canara Bank has more than 6,300 branches spread across 4,400+ cities along with 8,800+ ATMs. As of 2019, the employee strength of Canara Bank is 58,000+ with total assets to the tune of Rs. 711,782 crores.

Product	Interest Rates
Canara Bank Personal Loan	10.90%
Canara Bank Home Loan	6.65%

These top commercial banks in India not only offer assistance to every citizen to open a bank account to facilitate monetary transactions but also extend various types of loans which give impetus to the growth of the country.

4.7. SUMMARY

Commercial banks are an important part of the economy. Not only do they provide consumers with an essential service, but they also help create capital and liquidity in the market. They ensure liquidity by taking the funds that their customers deposit in their accounts and lending them out to others. Commercial banks play a role in the creation of credit, which leads to an increase in production, employment, and consumer spending, thereby boosting the economy. As such, commercial banks are heavily regulated by a central bank in their country or region. For instance, central banks impose reserve requirements on commercial banks. This means banks are required to hold a certain percentage of their consumer deposits at the central bank as a cushion if there's a rush to withdraw funds by the general public. HDFC Bank is the best commercial bank in India because of the following reasons: It was amongst the first banks to receive an 'in principle' approval from the RBI or Reserve Bank of India to set up a bank in the private sector in 1994. It is the top Constituents in Bank Nifty. It has a total revenue of Rs. 105,161 Crores in 2021. It employs 98061 employees. It has a network of 13,160 ATMs and 5,103 branches in India. It has a customer base of over 49 million. At present, the State Bank of India (SBI) is the **biggest commercial bank in India**. SBI is a public sector bank and has its headquarters in Mumbai, Maharashtra. It has a total of 16 regional hubs and 57 zonal offices located at almost every city throughout India. With 16 regional hubs and 57 zonal offices present in almost every city across India, the State Bank of India (SBI) is the **largest commercial bank in India**. It is a public sector bank with its headquarters located in Mumbai, Maharashtra.

4.8. TECHNICAL TERMS

Commercial banks: The term "commercial bank" refers to a financial institution that accepts deposits, offers checking account services, makes various loans, and offers basic financial products like certificates of deposit (CDs) and savings accounts to individuals and small businesses.

Production: Production may also refer to the goods being produced. For instance, some business call a set of products being produced at the same time a production run. Both of these definitions are interchangeable. Basically, it just means a manufacturing process or the end result of a manufacturing process.

Employment: Employment is an agreement between an individual and another entity that stipulates the responsibilities, payment terms and arrangement, rules of the workplace, and is recognized by the government.

Consumer spending: Consumer spending is the total money spent on final goods and services by individuals and households for personal use and enjoyment in an economy. Contemporary measures of consumer spending include all private purchases of durable goods, nondurable goods, and services.

Central bank : Central bank or monetary authority is a monopolized and often nationalized institution given privileged control over the production and distribution of money and credit. In modern economies, the central bank is usually responsible for the formulation of monetary policy and the regulation of member banks.

4.9. SELF ASSESSMENT QUESTIONS

1. Explain the origin and growth of Central Bank of India
2. Give the organization structure and major functions of Commercial Banking.
3. What is the main purpose of commercial banks?
4. HDFC Bank is the best commercial bank in India—Explain.
5. State Bank of India (SBI) is the largest commercial bank in India—Illustrate?
6. Explain briefly regarding top 10 Commercial banks in India.

4.10. SUGGESTED READINGS

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Dr. B. Padmaja

LESSON -5
FEDERAL RESERVE SYSTEM

LEARNING OBJECTIVES

To know the concept of federal banking system
To understand the origin of the federal system
To know the structure and its components of the federal banking system
To examine the role of various components of the system

STRUCTURE

5.1 INTRODUCTION

The Federal Reserve System is the central bank of the United States. Founded by an act of Congress in 1913, the Federal Reserve System was established with several goals in mind. Perhaps most important was to make the American banking system more stable. Banking panics—events characterized by widespread bank runs and payments suspensions and, to a degree, outright bank failureshad occurred often throughout the 19th century. Such panics were widely blamed on the nation's "inelastic currency."

The national banking acts of the 1860s created an environment in which most of the nation's currency consisted of notes issued by national banks (commercial banks with charters issued by the federal government) comprised most of the nation's currency. The volume of notes that a national bank could issue was tied to the amount of U.S. government bonds the bank held. The supply of notes was largely unresponsive to changes in demand, especially when an unforeseen event or news caused bank customers to worry about the safety of their deposits and "run" to their banks to withdraw cash.

Reformers focused on ways to expand the supply of notes rapidly to meet the public’s demand for liquidity. The desire for an “elastic” currency was ultimately realized by the creation of the Federal Reserve and a new currency form—the Federal Reserve note. Federal Reserve notes are the predominant form of U.S. currency today and supplied in amounts needed to meet demand.

More broadly, the Federal Reserve System was established to improve the flow of money and credit throughout the United States in an effort to ensure that banks had the resources to meet the needs of their customers in all parts of the country.

5.2 ORIGIN OF FEDERAL RESERVE SYSTEM

The Federal Reserve System (“Fed”) is the central bank of the United States. This website serves as a gateway to the history of the Federal Reserve for educators, students, and the general public. The Fed has a complex structure and mission.

5.3 HOW IT ALL BEGAN?

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5.4 BEFORE THE FEDERAL RESERVE SYSTEM

The Federal Reserve System was established by Congress over a century ago to serve as the U.S. central bank. President Woodrow Wilson signed the Federal Reserve Act into law on December 23, 1913. Prior to the creation of the Fed, the U.S. economy was plagued by frequent episodes of panic, bank failures, and scarce credit. The history of the Federal Reserve is bound up in the effort to build a more stable and secure financial system. This section describes key events leading to the establishment of the Federal Reserve System and how the Fed has evolved to meet the needs of the United States economy.

5.5 MONEY AND BANKING IN COLONIAL AMERICA

Prior to gaining independence from British rule, American colonists were limited to using European coins, commodity money, and barter as their primary means of exchange. Troubled by shortages in foreign coins and the inefficiencies of barter and commodity money, many colonies decided to mint coins and issue paper currency for transactions.

Banks in the colonies did not take deposits or make loans. Instead, they issued paper currency (commodity money) backed by land or precious metals such as gold. The primary sources of credit or loans came through wealthy merchants and other individuals. This was ineffective. People lacked faith in colonial currency and the right of a colony to issue money was often challenged by their British rulers.

5.6 EXPERIMENTS WITH CENTRAL BANKING

Central banking in the United States began with the ratification of our Constitution in 1789. Secretary of the Treasury Alexander Hamilton developed a plan for a federal banking system to solve the nation’s credit problems after the War of Independence. This was controversial. Hamilton’s plan, backed by business and financial leaders from the northeastern states, called for the creation of a federal bank to provide credit to government and businesses. The new federal bank would also establish a national currency, replacing the notes issued by the colonies. In addition, the federal bank would carry out all financial matters for the U.S. government and provide a safe place to store government funds.

Secretary of State Thomas Jefferson led the opposition to Hamilton’s plan. Jefferson represented the country’s farming interests, which looked with suspicion at a central government bank and generally favored states’ rights over federal powers. He argued that the Constitution did not authorize the federal government to charter a national bank or issue paper currency.

Hamilton, supported by the Federalist Party, won the debate. The First Bank of the United States was chartered in 1791. Twenty years later, a bill to re-charter the bank failed. Without a centralized banking and credit structure, state banks took on the same role as the original colonies and began issuing their own paper currencies, often of questionable value. In 1816, Congress attempted to solve the country’s financial problems by chartering the Second Bank of the United States. This second bank lasted until 1836, when President Andrew Jackson declared it unconstitutional and vetoed its re-charter.

5.7 FREE BANKING ERA

A period known as the Free Banking Era followed the demise of the Second Bank of the United States. Over the next 25 years, U.S. banking was a hodgepodge of state-chartered banks operating without any federal regulation. By 1860, there were nearly 8,000 state banks, each issuing its own paper notes. Some of the more questionable banks were known as “wildcat banks,” supposedly because they maintained offices in remote areas (“where the wildcats are”). This made it difficult for customers to exchange their notes for gold or silver.

The need for reliable financing during the Civil War prompted the passage of the National Banking Act in 1863. The legislation created a uniform national currency and permitted only nationally chartered banks to issue bank notes. The legislation cleared up the problem of thousands of different bank notes circulating in the U.S. at the time, but did not create a strong central banking structure.

5.8 FINANCIAL PANICS, BANK RUNS, AND THE CREATION OF THE FED

As the industrial economy expanded following the Civil War, the weaknesses of the nation's decentralized banking system became more serious. Bank panics or "runs" occurred regularly. Many banks did not keep enough cash on hand to meet customer needs during these periods of heavy demand, and were forced to shut down. News of one bank running out of cash would often cause a panic at other banks, as worried customers rushed to withdraw money before their bank failed. If a large number of banks were unable to meet the sudden demand for cash, it would sometimes trigger a massive series of bank failures. In 1907, a particularly severe panic ended only when a private individual, the financier J.P. Morgan, used his personal wealth to arrange emergency loans for banks.

The 1907 financial panic fueled a reform movement. Many Americans had become convinced that the nation needed a central bank to oversee the nation's money supply and provide an "elastic" currency that could expand and contract in response to fluctuations in the economy's demand for money and credit. After several years of negotiation and discussion, Congress established the Federal Reserve System in 1913.

5.9 EVOLUTION OF THE FEDERAL RESERVE SYSTEM

Since the creation of the Federal Reserve, other pieces of legislation have shaped the structure and operation of our nation's central bank. Each of the key changes highlighted below resulted from periods of instability in the economy. Following the Great Depression, Congress passed the Banking Act of 1935. That act established the Federal Open Market Committee (FOMC) as the Fed's monetary policy-making body. During a period of very high inflation, Congress enacted The Federal Reserve Reform Act of 1977. It explicitly set price stability as a national policy goal for the first time. Stable prices help people and businesses make financial decisions without worrying about where prices are headed. Economies with stable prices tend to be healthier in the long run.

The very next year, Congress passed The Full Employment and Balanced Growth Act of 1978, which established the second policy goal as full employment. It also required the Fed to report to Congress on policy goals twice a year. Finally, following the severe financial crisis of 2007-2008, Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act in 2010. More commonly known as the Dodd-Frank Act, this law affected the Fed in many ways. It changed the Fed's governance, made its operations more open to scrutiny, and expanded its supervisory responsibilities.

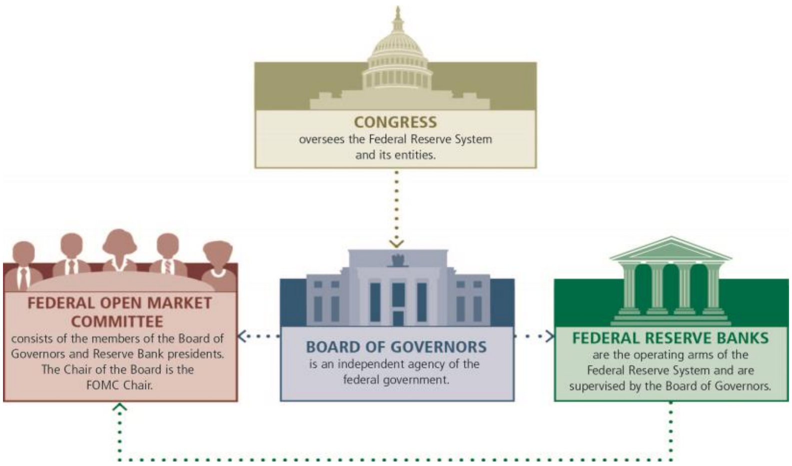
5.9.1 Functions of Federal Reserve System

The Federal Reserve System is the central bank of the United States is performing five general functions to promote the effective operation of the U.S. economy and, more generally, the public interest. The Federal Reserve

- **conducts the nation's monetary policy** to promote maximum employment, stable prices, and moderate long-term interest rates in the U.S. economy;
- **promotes the stability of the financial system** and seeks to minimize and contain systemic risks through active monitoring and engagement in the U.S. and abroad;
- **promotes the safety and soundness of individual financial institutions** and monitors their impact on the financial system as a whole;
- **fosters payment and settlement system safety and efficiency** through services to the banking industry and the U.S. government that facilitate U.S.-dollar transactions and payments; and
- **Promotes consumer protection and community development** through consumer-focused supervision and examination, research and analysis of emerging consumer issues and trends, community economic development activities, and the administration of consumer laws and regulations.

5.9.2 The Three Key Federal Reserve Entities

The Federal Reserve Board of Governors (Board of Governors), the Federal Reserve Banks (Reserve Banks), and the Federal Open Market Committee (FOMC) make decisions that help promote the health of the U.S. economy and the stability of the U.S. financial system.



5.9.3 Organizational Structure of FRS

The Federal Reserve System has a structure designed by Congress to give it a broad perspective on the economy and on economic activity in all parts of the nation. It is a federal system, composed basically of a central, governmental agencythe Board of Governorsin Washington, D.C., and twelve regional Federal Reserve Banks, located in major cities throughout the nation. These components share responsibility for supervising and regulating certain financial institutions and activities; for providing banking services to depository institutions and to the federal government; and for ensuring that consumers receive adequate information and fair treatment in their business with the banking system.

A major component of the System is the Federal Open Market Committee (FOMC), which is made up of the Board of Governors, the president of the Federal Reserve Bank of New York, and presidents of four other Federal Reserve Banks, who serve on a rotating basis. The FOMC oversees open market operations, which is the main tool used by the Federal Reserve to influence money market conditions and the growth of money and credit.

Two other groups play roles in the way the Federal Reserve System works: depository institutions, through which the tools of monetary policy operate, and advisory committees, which make recommendations to the Board of Governors and to the Reserve Banks regarding the System’s responsibilities

5.9.4 Board of Governors

The Board of Governors of the Federal Reserve System was established as a federal government agency. It is made up of seven members appointed by the President of the United States and confirmed by the U.S. Senate. The full term of a Board member is fourteen years; the appointments are staggered so that one term expires on January 31 of each even-numbered year. After serving a full term, a Board member may not be reappointed. If a member leaves the Board before his or her term expires, however, the person appointed and confirmed to serve the remainder of the term may later be reappointed to a full term.

The Chairman and the Vice Chairman of the Board are also appointed by the President and confirmed by the Senate. The nominees to these posts must already be members of the Board or must be simultaneously appointed to the Board. The terms for these positions are four years.

The Board of Governors is supported by a Washington staff numbering about 1,700. The Board’s responsibilities require thorough analysis of domestic and international financial and economic developments. The Board carries out those responsibilities in conjunction with other components of the Federal Reserve System. It also supervises and regulates the operations of the Federal Reserve Banks and their Branches and the activities of various banking organizations, exercises broad responsibility in the nation’s payments system, and administers most of the nation’s laws regarding consumer credit protection. The Federal Reserve System conducts monetary policy using three major tools:

- **Open market operations:** The buying and selling of U.S. government (mainly Treasury) securities in the open market to influence the level of reserves in the depository system.
- **Reserve requirements**: Requirements regarding the amount of funds that commercial banks and other depository institutions must hold in reserve against deposits
- **The discount rate**: The interest rate charged commercial banks and other depository institutions when they borrow reserves from a regional Federal Reserve Bank.

Policy regarding open market operations is established by the FOMC. However, the Board of Governors has sole authority over changes in reserve requirements, and it must also approve any change in the discount rate initiated by a Federal Reserve Bank.

The Federal Reserve also plays a major role in the supervision and regulation of the U.S. banking system. Banking supervision—the examination of institutions for safety and soundness and for compliance with law—is shared with the Office of the Comptroller of the Currency, which supervises national banks, and the Federal Deposit Insurance Corporation, which supervises state banks that are not members of the Federal Reserve System. The Board's supervisory responsibilities extend to the roughly 1,000 state banks that are members of the Federal Reserve System, all bank holding companies, the foreign activities of member banks, the U.S. activities of foreign banks, and Edge Act and agreement corporations (institutions that engage in a foreign banking business).

Some regulations issued by the Board apply to the entire banking industry, whereas others apply only to member banks, that is, state banks that have chosen to join the Federal Reserve System and national banks, which by law are automatically members of the System. The Board also issues regulations to carry out major federal laws governing consumer credit protection, such as Truth in Lending, Equal Credit Opportunity, and Home Mortgage Disclosure; many of these regulations apply to various lenders outside the banking industry as well as to banks.

Members of the Board of Governors are in continual contact with other policymakers in government. They frequently testify before congressional committees on the economy, monetary policy, banking supervision and regulation, consumer credit protection, financial markets, and other matters. Under the Humphrey–Hawkins Act, the Board of Governors must submit a report on the economy and the conduct of monetary policy to Congress by February 20 and July 20 of each year. The Chairman of the Board of Governors is called to testify on the report before the Senate Committee on Banking, Housing, and Urban Affairs and the House Committee on Banking, Finance and Urban Affairs.

The Board has regular contact with members of the President's Council of Economic Advisers and other key economic officials, and the Chairman meets from time to time with the President of the United States and has regular meetings with the Secretary of the Treasury.

The Chairman has formal responsibilities in the international arena as well. For example, he is the alternate U.S. member of the Board of Governors of the International Monetary Fund, is a member of the board of the Bank for International Settlements (BIS), and is a member, along with the heads of other relevant U.S. agencies and departments, of the National Advisory Council on International Monetary and Financial Policies. He is also a member of U.S. delegations to key international meetings, such as those of the finance ministers and central bank governors of the seven largest industrial countries—the Group of Seven, or G-7. He, other Board members, and Board staff members share many international responsibilities, including representing the Federal Reserve at meetings at the BIS in Basle and at the Organization for Economic Co-operation and Development in Paris.

One member of the Board of Governors serves as the System's representative to the Federal Financial Institutions Examination Council (FFIEC), which is responsible for coordinating, at the federal level, examinations of depository institutions and related policies. The FFIEC has representatives also from the Federal Deposit Insurance Corporation, the National Credit Union Administration, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision.

The Board publishes detailed statistics and other information about the System's activities and the economy in publications such as the monthly Federal Reserve Bulletin, special announcements of Board actions, and separate statistical releases. Through the Federal Reserve Regulatory Service, it provides materials relating to its regulatory and supervisory functions.The Board is audited annually by a major public accounting firm, and the audit report is published in the Board's Annual Report. The General Accounting Office (GAO) also audits the Board. A complete list of audits or studies performed and under way by the GAO is available in the Board's annual Budget Review, which is sent to Congress during the first quarter of each calendar year. Monetary policy, which is exempt from audit by the GAO, is monitored directly by Congress through written reports, including the semiannual Humphrey–Hawkins reports, prepared by the Board of Governors.

5.9.5 Federal Reserve Banks

A network of twelve Federal Reserve Banks and their twenty-five Branches carries out a variety of System functions, including operating a nationwide payments system, distributing the nation's currency and coin, supervising and regulating member banks and bank holding companies, and serving as banker for the U.S. Treasury. Each Reserve District is identified by a letter and a number (see list of District offices on page 10). All U.S. currency carries the letter and number designation of the Reserve Bank that first puts it into circulation. Besides carrying out functions for the System as a whole, such as administering nationwide banking and credit policies, each Reserve Bank acts as a depository for the banks in its own District and fulfills other District responsibilities.

The Board of Governors exercises broad authority over the operations and activities of the Federal Reserve Banks and their Branches. This authority includes oversight of the Reserve Banks' services to banks and other depository institutions and of their examination and supervision of various banking institutions. Each Federal Reserve Bank must submit its annual budget to the Board of Governors for approval. Other types of expenditures—such as those for construction or major alterations of Reserve Bank buildings and for the salaries of Reserve Bank presidents and first vice presidentsare also subject to specific Board approval.

Congress chartered the Federal Reserve Banks for a public purpose. The Reserve Banks are the operating arms of the central banking system, and they combine both public and private elements in their makeup and organization. As part of the Federal Reserve System, the Banks are subject to oversight by Congress; and like the Board members, Reserve Bank presidents may testify before congressional committees. Each Reserve Bank has a staff of full-time officers and employees that manages and operates it.

Each Reserve Bank has its own board of nine directors chosen from outside the Bank as provided by law. Three directors, designated Class A, represent commercial banks that are members of the Federal Reserve System. Three Class B and three Class C directors represent the public. The member commercial banks in each District elect the Class A and Class B directors. The Board of Governors in Washington, D.C., appoints the Class C directors to their posts. From the Class C directors, the Board of Governors selects one person as chairman and another as deputy chairman. No Class B or Class C director may be an officer, director, or employee of a bank or a bank holding company. No Class C director may own stock in a bank or a bank holding company. The directors in turn nominate a president and first vice president of the Reserve Bank, whose selection is subject to approval by the Board of Governors. Each Branch of a Reserve Bank has its own board of directors of five or seven members. A majority of these directors are appointed by the Branch’s Reserve Bank; the others are appointed by the Board of Governors.

Boards of directors of the Reserve Banks and Branches provide the Federal Reserve System with a wealth of information on economic conditions in virtually every corner of the nation. This information is used by the FOMC and the Board of Governors in reaching major decisions about monetary policy. Information from directors and other sources gathered by the Reserve Banks is also shared with the public in a special reportinformally called the Beige Book—which is issued about two weeks before each meeting of the FOMC. In addition, every two weeks, the board of each Bank must recommend to the Board of Governors a discount rate for its Bank; a recommendation for a change cannot take effect unless the Board of Governors approves it.

The income of the Federal Reserve System is derived primarily from the interest on U.S. government securities that it has acquired through open market operations. Other major sources of income are the interest on foreign currency investments held by the System; interest on loans to depository institutions (the rate on which is the so-called discount rate); and fees received for services provided to depository institutions, such as check clearing, funds transfers, and automated clearinghouse operations.

After it pays its expenses, the Federal Reserve turns the rest of its earnings over to the U.S. Treasury. About 95 percent of the Reserve Banks’ net earnings have been paid into the Treasury since the Federal Reserve System began operations in 1914. (Income and expenses of the Federal Reserve Banks from 1914 to the present are included in the Annual Report of the Board of Governors.) If a Reserve Bank were liquidated for any reason, all proceeds after the payment of bills would also be turned over to the Treasury.

The Board of Governors audits the Reserve Banks every year, and its staff periodically reviews operations in key functional areas. The Reserve Banks, like the Board, are subject to audit by the GAO, but certain functions, such as transactions with foreign central banks and open market operations, are excluded from audit. Each Reserve Bank has an internal auditor who is responsible to the Bank’s board of directors.

5.9.6 Federal Open Market Committee

The FOMC is charged under law with overseeing open market operations, the principal tool of national monetary policy. These operations influence the number of reserves available to depository institutions. The FOMC also sets ranges for the growth of the monetary aggregates and directs operations undertaken by the Federal Reserve in foreign exchange markets.

The FOMC is composed of the seven members of the Board of Governors and five of the twelve Reserve Bank presidents. The president of the Federal Reserve Bank of New York is a permanent member; the other presidents serve one-year terms on a rotating basis.1 All the presidents participate in FOMC discussions, contributing to the Committee's assessment of the economy and of policy options, but only the five presidents who are members of the Committee vote on policy decisions. The FOMC under law determines its own internal organization and by tradition elects the Chairman of the Board of Governors as its chairman and the president of the Federal Reserve Bank of New York as its vice chairman. Formal meetings are held eight times each year in Washington, D.C. Telephone consultations and other meetings are held when needed.

5.9.7 Member Banks

As suggested previously, the nation's banks can be divided into three types according to which governmental body charters them and whether or not they are members of the Federal Reserve System. Those chartered by the federal government (through the Office of the Comptroller of the Currency in the Department of the Treasury) are national banks; by law, they are members of the Federal Reserve System. Banks chartered by the states are divided into those that are members of the Federal Reserve System (state member banks) and those that are not (state nonmember banks).State banks are not required to join the Federal Reserve System, but they may elect to become members if they meet the standards set by the Board of Governors. At the end of 1993, 4,338 banks were members of the Federal Reserve System3,360 national banks and 978 state banksout of 11,212 commercial banks nationwide.

Member banks must subscribe to stock in their regional Federal Reserve Bank in an amount equal to 3 percent of their capital and surplus. The holding of this stock, however, does not carry with it the control and financial interest conveyed to holders of common stock in for-profit organizations: It is merely a legal obligation that goes along with membership, and the stock may not be sold or pledged as collateral for loans. Member banks receive a 6 percent dividend annually on their stock, as specified by law, and vote for the Class A and Class B directors of the Reserve Bank. The stock is not available for purchase by individuals.

5.10 ADVISORY COMMITTEES

The Federal Reserve System uses advisory and working committees in carrying out its varied responsibilities. Three of these committees advise the Board of Governors directly:

- **Federal Advisory Council:** The Federal Reserve Act established the council, which consists of one member—traditionally a commercial banker—from each Federal Reserve District. The council is required by law to meet four times each year with the Board of Governors in Washington, D.C., to discuss economic and banking matters.

- **Consumer Advisory Council:** This statutory council, which has thirty members, meets with the Board three times a year on matters concerning consumers and the consumer credit protection laws administered by the Board. The council consists of academics, legal specialists in consumer matters, and members representing the interests of consumers and the financial industry.

- **Thrift Institutions Advisory Council**:After the passage of the Depository Institutions Deregulation and Monetary Control Act of 1980, which extended to thrift institutions the Federal Reserve's reserve requirements and access to the discount window, the Board of Governors established this council to obtain information and opinions on the needs and problems of thrift institutions. The council is made up of representatives of savings and loan associations, savings banks, and credit unions.

The Federal Reserve Banks also use advisory committees. Perhaps the most important are the committees (one for each Reserve Bank) that advise the Banks on matters of agriculture and small business. Two representatives of each committee meet once a year in Washington, D.C., with the Board of Governors.

5.11 THE DECENTRALIZED SYSTEM PHILOSOPHY

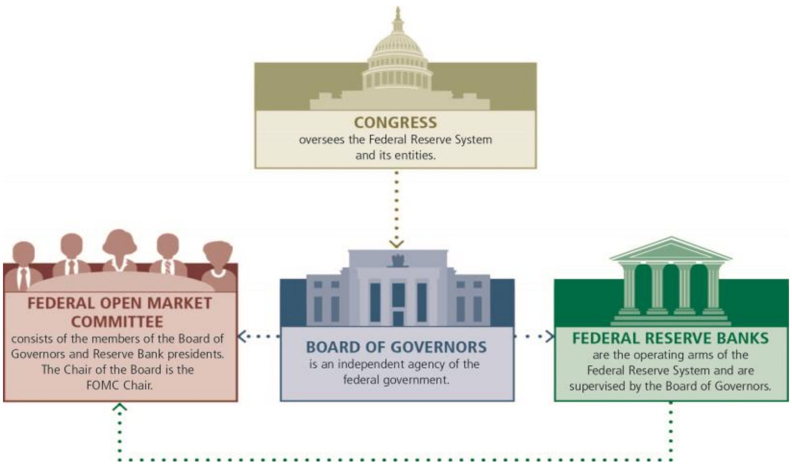
In establishing the Federal Reserve System, the United States was divided geographically into 12 Districts, each with a separately incorporated Reserve Bank. District boundaries were based on prevailing trade regions that existed in 1913 and related economic considerations, so they do not necessarily coincide with state lines.

As originally envisioned, each of the 12 Reserve Banks was intended to operate independently from the other Reserve Banks. Variation was expected in discount rates--the interest rate that commercial banks were charged for borrowing funds from a Reserve Bank. The setting of a separately determined discount rate appropriate to each District was considered the most important tool of monetary policy at that time. The concept of national economic policymaking was not well developed, and the impact of open market operations--purchases and sales of U.S. government securities--on policymaking was less significant.

As the nation's economy became more integrated and more complex, through advances in technology, communications, transportation, and financial services, the effective conduct of monetary policy began to require increased collaboration and coordination throughout the System. This was accomplished in part through revisions to the Federal Reserve Act in 1933 and 1935 that together created the modern-day Federal Open Market Committee (FOMC).
The Depository Institutions Deregulation and Monetary Control Act of 1980 (Monetary Control Act) introduced an even greater degree of coordination among Reserve Banks with respect to the pricing of financial services offered to depository institutions. There has also been a trend among Reserve Banks to centralize or consolidate many of their financial services and support functions and to standardize others. Reserve Banks have become more efficient by entering into intra-System service agreements that allocate responsibilities for services and functions that are national in scope among each of the 12 Reserve Banks.

5.12 THE THREE KEY FEDERAL RESERVE ENTITIES

The Federal Reserve Board of Governors (Board of Governors), the Federal Reserve Banks (Reserve Banks), and the Federal Open Market Committee (FOMC) make decisions that help promote the health of the U.S. economy and the stability of the U.S. financial system.



5.13 OTHER ENTITIES CONTRIBUTING TO FEDERAL RESERVE FUNCTIONS

Two other groups play important roles in the Federal Reserve System's core functions:

1. depository institutions-banks, thrifts, and credit unions; and
2. Federal Reserve System advisory committees, which make recommendations to the Board of Governors and to the Reserve Banks regarding the System's responsibilities.

5.13.1 Depository Institutions

Depository institutions offer transaction, or checking, accounts to the public, and may maintain accounts of their own at their local Federal Reserve Banks. Depository institutions are required to meet reserve requirements--that is, to keep a certain amount of cash on hand or in an account at a Reserve Bank based on the total balances in the checking accounts they hold.

Depository institutions that have higher balances in their Reserve Bank account than they need to meet reserve requirements may lend to other depository institutions that need those funds to satisfy their own reserve requirements. This rate influences interest rates, asset prices and wealth, exchange rates, and thereby, aggregate demand in the economy. The FOMC sets a target for the federal funds rate at its meetings and authorizes actions called open market operations to achieve that target.

5.13.2 Advisory Councils

The Federal Advisory Council (FAC), which is composed of twelve representatives of the banking industry, consults with and advises the Board on all matters within the Board's jurisdiction. The council ordinarily meets four times a year, the minimum number of meetings required by the Federal Reserve Act. These meetings are always held in Washington, D.C., customarily on the first Thursday of February, May, September, and December, although occasionally the meetings are set for different times to suit the convenience of either the council or the Board. Each year, each Reserve Bank chooses one person to represent its District on the FAC, and members customarily serve three one-year terms. The members elect their own officers.

Five advisory councils assist and advise the Board on matters of public policy.

1. **Federal Advisory Council (FAC).** This council, established by the Federal Reserve Act, comprises 12 representatives of the banking industry. The FAC ordinarily meets with the Board four times a year, as required by law. Annually, each Reserve Bank chooses one person to represent its District on the FAC. FAC members customarily serve three one-year terms and elect their own officers.

2. **Community Depository Institutions Advisory Council (CDIAC).** The CDIAC was originally established by the Board of Governors to obtain information and views from thrift institutions (savings and loan institutions and mutual savings banks) and credit unions. More recently, its membership has expanded to include community banks. Like the FAC, the CDIAC provides the Board of Governors with firsthand insight and information about the economy, lending conditions, and other issues.

3. **Model Validation Council.** This council was established by the Board of Governors in 2012 to provide expert and independent advice on its process to rigorously assess the models used in stress tests of banking institutions. Stress tests are required under the Dodd-Frank Wall Street Reform and Consumer Protection Act. The council is intended to improve the quality of stress tests and thereby strengthen confidence in the stress-testing program.

4. **Community Advisory Council (CAC).** This council was formed by the Federal Reserve Board in 2015 to offer diverse perspectives on the economic circumstances and financial services needs of consumers and communities, with a particular focus on the concerns of low- and moderate-income populations. The CAC complements the FAC and CDIAC, whose members represent depository institutions. The CAC meets semiannually with members of the Board of Governors. The 15 CAC members serve staggered three-year terms and are selected by the Board through a public nomination process.

5. **Insurance Policy Advisory Committee (IPAC).** This council was established at the Board of Governors in 2018 by section 211(b) of the Economic Growth, Regulatory Relief, and Consumer Protection Act. The IPAC provides information, advice, and recommendations to the Board on international insurance capital standards and other insurance issues.

Federal Reserve Banks also have their own advisory committees. Perhaps the most important of these are committees that advise the Banks on agricultural, small business, and labor matters. The Federal Reserve Board solicits the views of each of these committees biannually.

5.14 SUMMERY

The origin of the Federal Reserve System is not and event, it is an evolution of the economy. Reserve system controlled and organized not only the economy but also the banking system. The system organized and controlled by the committees with decentralized system. It takes some other entities for smooth functioning of the organization.

5.15 KEY WORDS

Federal Reserve System
panic fueled
money supply
Balanced Growth
Wall Street
monetary policy
Federal Open Market
Open market operations
discount rate
Consumer Advisory Council
Thrift Institutions Advisory Council:
Depository institutions

5.16 SELF ASSESSMENT QUESTIONS

1. Explain the functions of advisory council.
2. What are the three key federal reserve entities?
3. Brief about Federal Reserve Banks of USA.
4. What are the functions of board of Governors?

5.17 FURTHER READINGS

1. Sayers R.S. Modern Banking.
2. Machenize K. Banking Systems of Great Britain, French, Germany and U.S.A
3. Goswami VK International Banking

Dr. K. Sivaji

LESSON -6
COMMERCIAL BANKING IN USA

LEARNING OBJECTIVES

To know the concept of Commercial banking system
To understand the nature of working of banks in USA
To know the weakness and strengths of banking system
To examine the various components of the system

STRUCTURE

6.1 Introduction
6.2 The banking during the colonial period in United States
6.3 First Commercial Bank in the United States
6.4 Causes for rise of banking institutions in USA
6.5 What types of banks are there in the United States?
6.6 How do banks in the United States work?
6.7 How banks make Money?
6.8 Withdrawing money from Banks
6.9 Banking Regulations
6.10 What are Interest Rates?
6.11 Types of accounts you will use at a Bank
6.12 Summary
6.13 Technical Terms
6.14 Self Assessment Questions
6.15 Suggested Readings

6.1 INTRODUCTION

If Americans don't completely understand the US banking system, imagine how difficult it can be for a foreigner to understand. Unfortunately, the complex system tends to confuse all who come across it. Although it is frustrating, it is extremely important to understand so that you can have a better idea of what is going on with your money. Continue reading this so you can learn more about the US banking system and what you need to know about it to properly manage your finances successfully.

6.2 THE BANKING DURING THE COLONIAL PERIOD IN UNITED STATES

The colonists knew that they required something for the development of their trade and natural resources which they did not possess, but their attempts to supply this deficiency show that they did not clearly understand their need. Their need was capital, but they fell into the error common to person possessing land in a new country. They thought what they needed was merely more money, and accordingly, instead of establishing agencies which might. have enabled them to make the best and most systematic use of the limited capital and credit which they did possess, they resorted to what seemed to them a much easier course, the issue of paper money.

In some respects, their course was at first a natural one. There was a real need of a larger medium of exchange. This need, which continued to be felt to a greater or less degree during the whole colonial period, was, it is true aggravated by the excessive issue of paper money, but nevertheless, it was a natural and real need. Metallic money is an expensive medium of exchange and new settlers on account of the necessity of employing all their capital productively are very loath to invest even a part of it in hard money, which is only a tool of exchange. Circulating notes are much cheaper. and providing their value can be assured, may to some extent, supply the need for money in domestic operation. The colonist therefore resorted to the issue of paper money, and it was issued to some extent in each of the thirteen colonies. This device was, however, employed "without limitation or judgment" ' so that instead of facilitating commercial intercourse, it became its worst barrier.

The so-called "banks" established in the colonies were mere paper money machines, and were not, as will be shown, commercial in character. In order to understand the conception of banking in America during the colonial period, it is necessary to study to some extent the history of the paper money issues. To the colonists, "banking projects", and "paper money schemes" were the same thing. Paper money was issued by "banks" both public and private. The term "bank," says Sumner, "was applied to the mass of bills provided for and loaned out at one time under one act of legislation" and the term was also commonly used to mean the issue of notes by individuals and private companies. In its strictest sense, the term "bank" was applied to an issue of notes that were loaned, and not to a public issue for the purpose of paying government expenses, but this distinction was not generally made, and public issues which were not loaned; were also spoken of as "banks".

The colonial period falls, naturally, into three distinct divisions as regards the nature of the banks established. Up to I690, the banks formed were private banks, issuing notes based upon land or imperishable merchandise; from 1690 to the downfall of the great Land Bank in 1741, both private banks and public banks were formed, issuing notes based upon land, imperishable merchandise, or specie; and from 1741 to the end of the period, public banks of a similar nature continued, but with the exception of the Bank of Pennsylvania chartered in 1780, no private banks were formed.

The first banking project, to which any reference can be found, was in I652. In May of that year, the General Court of Massachusetts appointed a council "To consider all sorts of trading, and to consult about the best ways of improving the same" etc. and in the same year there is an allusion to "what has been thought of by any for raising a Bank" etc. t It is also known that about the same time "for some years paper bills passed for payment of debts." Nothing more definite is known about this early attempt The first "bank" in America about which anything definite is known, was one started in Massachusetts in March, I671, by the Rev. John Woodbridge. Mr. Woodbridge did not succeed in establishing this bank firmly. It existed only a short time, and no bills were issued. In 1681 it was reestablished as a private bank of credit, by which notes were issued. A pamphlet attributed to Mr. Woodbridge, which was presented to the Massachusetts Council in 1667, shows the nature of this bank. The substance of the pamphlet is well indicated by its title, which is, "A Proposal for erecting a Fund of Land by Authority, or Private Persons, in the nature of a money Bank; or a merchandise Lumber, to pass Credit upon, by Book Entries or Bills of Exchange, for great Payments; and change bills for running cash. Wherein is demonstrated First, the necessity of having a Bank to inlarge the measure of Dealings in this Land, by showing the benefit of money, if enough to mete Trade with; and the disadvantage when it is otherwise; and Secondly, That Credit passed in Fund, by Book and Bills (a afore) will fully supply the defect of 1oney. "Wherein is related, of how little value Coin, as a Measure of Trade, need be, in itself; what inconveniences subject to. The worth a fund-bill, or Payment therein is of, & not of that Hazard". The plan and the arguments supporting it, say Trumbull, do not differ widely from theMassachusetts Land Bank of 17I4. It was a private bank not chartered by the colony. There is no record of how long it remained in existence, and but little is known of the extent of its operations. Felt makes note of the fact that it did not ruin it projectors.

The first chartered bank in the colonies was established by John Blackwell of Bo ton in 1686. The nature of this bank is shown by the proposal for a charter, and by the report of the action of Governor Dudley and his council, who approved the plan as presented without change. The bank is operated as a land bank, while, as hasbeen shown, the action taken by the President and his council permitted also the issue of note upon personal estates and imperishable merchandize. The association continued its operations only a short time, certainly not after the issue of the provincial paper money in 1690.

Another attempt to form a private bank for the issue of notes was made in 1689, by a number of citizens of Philodelphia. The minutes of the Council for February 7th of 1689, thus makes note of the scheme. It is not known whether this band was established or not.

The few cases constitute the known banking projects in the colonies before 1690. The banks formed before that time were all of one kind, private banks, issuing notes based upon land and imperishable merchandise. The establishment of a public bank in Massachusetts in 1690 and later in some of the other colonies, marks the beginning of another class of banks, and stopped for a time the attempt to issue notes by private banks. The occasion for the first public bank in the colonies, was to provide means to meet the expenses incurred by the unsuccessful expedition to Canada. The Provincial Bank in Massachusetts was established in 1690, and the first issue of notes was limited to 7000 pounds. Other issues followed; 40,000 pounds being issued for the Canada expedition alone.

It was expected that these notes would be only a temporary expedient, issued in anticipation of taxes, but being once tried they proved such a tempting expedient that there were repeated issues and re-issues. For the first few years they were promptly called in by the payment of taxes, but in 1704 the policy began to be adopted of postponing the payment of the taxes, in anticipation of which the notes were issued, and "thus unnaturally". This policy of the postponement of taxes continued for more than a quarter of a century, and the time for the redemption of the treasury notes was repeatedly extended, with the result that depreciation se in.

By 1733, there was a general complaint throughout New England of the scarcity of money. The issues in Massachusetts and New Hampshire had been restricted to some extent by royal instructions. For about ten years previous to 1739, the general court of Massachusetts had been annually issuing bills for the charges of the government. The redemption of these bills had been continually put off as long as possible, and since royal instructions prevented them from going beyond the year 1741, that year would be loaded with taxes amounting to between thirty- and forty-thousand-pound sterling. To pay this large amount seemed impossible, and there was a general dread of withdrawing all the paper money from circulation without substituting some other medium in its place. Hutchinson propsed to the general court to borrow from Englandupon interest, a sufficient sum to redeem the outstandingbills, thus preventing a contraction of the currency and distributing the burden of taxation over a number of years. This proposal was rejected, a larger number favoring what was called the "Land Bank or Manufactory scheme", which had been revived in 1739. The Land Bank of 1740-41 began operation without a charter.

After the downfall of the Land Bank, no private bank for the issue of notes was established in the colonies until I78o, when the Bank of Pennsylvania was chartered by Congress to assist in carrying on the war. The disorders of the currency in the colonies were, however, not at an end. Private issues were prohibited, but from this time until after the establishment of the Federal Constitution the various colonies and later. the Continental Congress and the new states, continued to issue public bills of credit, with results that were even more disastrous than those of the earlier period.

The conception of banking in America during the colonial period as shown above pattern. None of the banks established were commercial in character. They did not receive upon deposit the surplus funds of the community and use them in supplying the needs of the community. In other words, they were not banks of deposit and discount. Banking consisted merely in the privilege of issuing notes. The banks formed were of different kinds, as has been shown. They were both public and private, and were either land banks, merchandise banks or specie banks according to the nominal basis upon which their issues were made.

6.3 FIRST COMMERCIAL BANKS IN THE UNITED STATES

Although no commercial banks were formed in America during the colonial period, some of the merchants and public men were, in the latter part of the period, planning and working for their establishment. As early as 1763, the large and growing business of the port of Philadelphia encouraged some of its principal merchants to consider the formation of a bank.

The outbreak of the Revolution delayed for a time the plans already begun for the establishment of a bank. Commerce was prostrated, and the energies of the public men, and to a large extent of the people generally, were directed toward vigorously prosecuting the war. The difficulties incurred providing means for carrying on the war would have been greatly lessened, by the aid of a well-established bank, as is abundantly shown by the later history of the Revolution. Congress lacked the power to enforce payment of taxes and the different colonies made but small and tardy returns on the requisitions made upon them. There were no established agencies through which Congress might negotiate either foreign or domestic loans. It had to rely wholly upon individual efforts and personal appeals. By the year 1780, the condition of the country had become critical. The army was poorly fed and clothed, and paid only in a depreciated paper currency. there was no money on hand to pay the soldiers or to buy supplies, and Congress was unable to do anything to allay the discontent. It was thought that every possible n1eans of raising funds had been tried and the resources of the Government seemed exhausted. Something had to be clone at once if the war were to be continued.

It was at the time of such gloomy and discouraging prospects that the ladies of Philadelphia raised by subscription $300,000 in paper currency, and other subscriptions were made to assist in obtaining recruits and supplies. This idea spread, and brought about the establishment in July of the Bank of Pennsylvania, by a number of patriotic persons who subscribed 300,000 pounds Pennsylvania currency in real money for the purpose of supplying and transporting food to the army.

This plan was proposed at a meeting in Philadelphia on June 17th 1780, and within a few days the subscriptions were all made. Ninety-two persons in all, pledging themselves for amounts varying from one to ten thousand pounds, signed the subscription list. The heading of this list shows the object of the bank.

All money received by the bank, were to be used solely in supplying the need of the army and in discharging the notes and expenses of the bank. It was expected that Congress would gradually, as it was able, repay all the money advanced, after which the bank should call in its notes and wind up its business. It began operations on July 17thafter having received the official recognition.

It will be seen that the Pennsylvania Bank was not a bank in the modern sense of the term any more than the banks described in the foregoing chapter. It was organized for a special purpose, and all of its fund were to that purpose, and not loaned. The money deposited or lodged in the hank was not subject to check at any time, but was borrowed for a specific time not exceeding six months. Hamilton spoke of the bank as "not an institution, but only a particular subscription for a particular purpose.

The credit is due of founding the fir t commercial bank in the United States, the Bank of North America, which was incorporated by Congress on 31st December, 1781. Thoma H. Goddard well said, in his account of banks in Europe and America, that "Robert Morris may justly be styled the father of the system of credit and paper circulation in the United States. The attempts that had been made before this time had come to naught. The plans of 1763 were, as we have seen, not carried out. It is believed that Hamilton had, as early as 1779, considered the establishment of a bank, but nothing definite is known of his plans.

In the same year he proposed to Morris, that a bank be established with a capital of 200 million dollars and in a letter to Morris on April 30th., 1781, he offered a plan for a bank with capita of three million pounds lawful money. This bank was to receive money on deposit from individuals, to be repaid when called for, or passed by order to the credit of others, and was to loan money to the public or to individuals at an interest not exceeding eight per cent.

Hamilton's plans were examined and considered by Moris, who had been made Superintendent of Finance on Feb, 28th 1781. He was, however, unwilling to attempt an undertaking on so large a scale, and drew up a plan of his own which, he thought, would be adequate to the national wants and more certain of popular approval.

The plan for the Bank of North America was presented to Congress, May 17th 1781, and provided for a National Bank with a capital stock of $400,000 issued in 1000 shares of four hundred dolar each, payable in gold and silver. Among other things, the plan provided "that the Board' of Directors determine the manner of doing business, and the rules and forms to be pursued, and dispose of the money and credit of the bank for the interest and benefit of the proprietors, and make from time to time such dividends out of the profits as they may think proper. The superintendent of the Finances of America shall have a right at all times, to examine into the affairs of the bank, and for that purpose shall have access to all the books and papers. After a lively debate, the plan was approved by Congress on May 28th, with a recommendation to the several states that no other bank or bankers be established during the war. The Ordinance of December. 31st., incorporating the Bank of North America, gave recognition to the fact that the Bank would be of great service to the government and that "the exigencies of the United State render it indispensably necessary that such an act be immediately passed.

The Bank of North America originated primarily as a government necessity, in a time of great national tress. The bank, was, in other words, not only to render aid to the government, but was to be a bank of deposit and discount, an agency through which assistance might be obtained, in the development of the natural resources of the country, its trade and commerce, "an institution," that most probably will continue as long as the United State ,and that will become a useful to commerce and agriculture in the day of peace as it must be to the government during the war. How well the bank fulfilled the purpose for which it was established may be seen from its subsequent history.

The bank opened its doors for business on Chestnut Street in Philadelphia on the 7th January, 1782. It began immediately to receive deposits and to discount commercial paper, and to render assistance to the government. Although the Bank of North America aided the government to some extent by making direct advances of money, yet it was not in this way that it proved of the greatest assistance in carrying on the war. It was indirectly through its general operations as a commercial bank that its services were the most valuable. In addition to all this it must be acknowledged that the credit and confidence which was revived by means of this institution formed the basis of that system through which the anticipations made within the bounds of the United States had, upon the first day of July, 1783, exceeded $820,000. The bank collects the scattered sums of idle money and puts them into circulation.

The people of the United States were quick to appreciate and to make use of the conveniences of the bank. As early as 1786. it had become an almost universal practice for depositors desiring fund and those making loans at the bank to accept a "bank credit" and draw "checks" upon it, instead of taking actual money or bank bills. The early and continued financial success of the bank admits of no doubt. The first dividend was paid in 1782, and from that time to the present, annual dividends have been declared. In 1782 a dividend of 8 ¾ per cent was paid. The next year the dividend was 14 ½ per cent and the third, in I 784, was for 13 ½ per cent, with an average dividend of 9 6-25 per cent.

The success of the Bank of North America was soon so well recognized, that it inspired the establishment of two other banks, the Massachusetts Bank in March, 1784, and the Bank of New York in June of the same year. An attempt was also made in 1784 to form a rival institution in Philadelphia, but the directors of the Bank of North America skillfully averted its establishment by throwing open to subscriptions 1000 new shares of stock at $400 a share, the price at which the first shares were sold, thus silencing the agitation for a second bank by giving the projectors stock in the established institution upon exceedingly favorable terms.

The general nature of the business carried on by the Bank of North America. The quotations from Webster give additional proofs that the bank was actually from the beginning a bank of deposit and discount, and also give some idea of the extent of its operations. Early as February, I784, its business had increased so much that it was deemed necessary to increase its capital stock to $900,000, and that it was further increased within a month to prevent the establishment of a rival bank in Philadelphia.

The Bank of North America was, as we have seen, the first Commercial Bank in the United States, but it was not long before other banks arose in imitation, the first, as already mentioned, being the Massachusetts Bank established in Boston in I784. Very little information is accessible concerning the origin and early history of this bank.

The next bank to be established was the Bank of New York, and it too, was modeled after the Bank of North America. The petition for a bank met with opposition in the Legislature, but the mercantile community was so desirous of obtaining a bank in New York, that it was thought best not to await legislation, and accordingly, the bank began business without a charter on June 9th., I784, with a capital stock of 500,000. Not only was the general plan of the Bank of New York the same as that of the Bank of North America, but the business methods adopted were also similar.

The Bank began immediately to receive deposits and to discount commercial paper. Among the first rules adopted were that "Discounts will be done on Thursday in every week, and bill and notes brought for discount must be left at the bank on Wednesday morning, under sealed cover, directed to William Seton, Cashier. But no discount will be made for longer than thirty days, nor will any note be discounted to pay a former one, etc., and that "money lodged at the bank may be withdrawn at pleasure, free of expense; but no draft will be paid beyond the balance of the account.

The Bank of New York was from the first successful, and although the opponents of the bank succeeded in defeating the application to the Legislature for a charter until I79I, its busine steadily increased in spite of the opposition, so that it was enabled to pay semi-annual dividends of 3 per cent from November 1st 1785, until November 1788, when the dividend was increased to 3 ½ per cent for the previous six months.

6.4 CAUSES FOR RISE OF BANKING INSTITUTIONS IN USA

Up to the year 1780 no commercial bank had been formed in the Colonies, and that after a beginning was made in 1781, other bank sprang up in imitation so that by 1802, there were thirty-three banks doing business in the United States. Commercial banking was known and practiced in Europe long before its introduction into America. America was throughout the whole colonial period pre - dominantly an agricultural community, and one of mall, self- sufficient household industries. These industries were in high repute throughout the Colonies , and were engaged in by the rich farmer as well as by the poor, although the wealthy and fa fashionable had a great liking for wearing apparel of English manufacture.

Every farmer and his sons raised wool and flax. performed the heavy labor, and made and kept in working order the various tools and implements necessary to convert those materials into clothing. The wife and daughters did the lighter and more dexterous work. They took the wool and flax and carded and spun them into yarn and thread. These they knit into mittens and stockings, or wove them into cloth and then made them into clothing. The culture of flax, the raising of sheep and the manufacture of wool were encouraged in every way possible, and contests in knitting, spinning and weaving were often held, where prizes were given for the quickest and best work. The skill often attained seems remarkable now, at a time when household manufacture has become almost a lost art.

Alice Morse Earle tells of one instance in his book, where the sheep were sheared, and a complete suit of clothes made in less than a week. Another case mentioned in her book also shows how quickly and well this domestic system supplied the demands of the time, - ‘Nancy Peabody's brother of Shelburne, New Hampshire, came home one night and said that he had lost his mittens while chopping in the woods. Nancy ran to a bundle of wool in the garret, carded and spun a great hank of yarn that night. It was soaked and scoured the next morning, and in twenty-four hours from the time the brother announced his loss, he had a fine new pair of double mittens. This system of home manufacture grew from small beginnings, and gradually developed in response to the necessities as they arose. By the time of the war these self-supporting industries extended throughout the whole country and each home contained within itself "almost all the original and necessary arts.

Under such conditions of industry, operation was so limited and of so simple a nature that very little circulating capita was necessary. From the beginning when assistance was required to carry on their small affairs, neighbor and friends usually furnished each other with the necessary loans and discounts. As the population of the Colonies increased and it became more difficult to know readily who wished to borrow and who had money to loan, the need of borrowers and lenders were still supplied without the assistance of banks.

Before 176o, America developed wholly along agricultural lines. Up to that time and even as late as the war, nearly all their manufactures were imported from England, and there were no manufacturing establishments in the Colonies of enough importance to require much capital or banking facilities. It has been the principal cause of the rapid progress of American Colonies towards wealth and greatness. They have no manufacture, those household and coarser manufactures excepted which necessarily accompany the progress of agriculture, and which are the work of the women and children in every private family. The absence of manufacturing even in its rudimentary form was especially a marked characteristic in the Southern Colonies.

Attempt were made from time to time (especially after the middle of the eighteenth century) to establish manufactures in the Colonies but the difficulties always proved too great, and but little success was realized. America remained up to the time of the Revolution, predominantly agricultural, with no capital devoted in any large measure to manufacturing, in the modern sense of the term. This condition of colonial industry has such an important bearing upon the main question under consideration that it is necessary to inquire to some extent into the cause of the absence of manufacture. The colonist was immoderately fond of British manufacture.

The condition was not o favorable to agriculture in the Northern Colonies. Their product entered largely into competition with the product of England, and trade restrictions prevented to a large extent a direct exchange for manufactured goods. They were, however, able up to the period of rigid trade restrictions beginning about I76o, to dispose oi' their products, and to procure manufactures by carrying on a roundabout trade, and there, as in the South, it was an economic loss to engage in manufacture. Manufactured goods could be imported from England much cheaper than they could be produced in the Colonies. The lack of capital and the scarcity of workmen were the chief obstacles

In spite of these drawbacks, manufacturing would undoubtedly have gained some foothold in the Colonies, had it not been for the rigid laws of Great Britain forbidding them to manufacture for themselves, and forcing upon them her own manufactured goods. The mercantile system represented the prevalent form of economic thought in Europe during the greater part of the 17th and 18th centuries. It exercised a dominant influence upon the practical statesmanship of England until the lucid and convincing doctrines of Adam Smith began to bear fruit at the close of the eighteenth century. In accordance with this system the aim of the English statesman was to secure for Great Britain a balance of trade as favorable as possible, or in other words to keep the exports larger than the imports, so that the amount of specie in the country would increase. Manufacturing was becoming an important industry of Great Britain, and one of the most effective methods of bringing in specie was to increase the consumption of English goods abroad. Consequently, the central purpose of the commercial legislation during this period, was the development of markets, and especially of a Colonial market, for English manufactures.

As early as 1650, this purpose becomes evident. The navigation act of 1650, and its extension in 1661 and 1663, provided among other things, that the Colonies should not be allowed to purchase in any but the British markets, any manufactured article which England had to sell. In 1696, Parliament created the Board of the Lords of Trade and Plantations for the purpose of exercising a general oversight over the Colonies, of making them more useful and beneficial to England, and of suppressing industries which might prove detrimental to her interests. To this board the Governors of the different Colonies were directed to make careful reports from time to time on the conditions of the colonial manufactures in order that they might be effectually destroyed. From this time to the close of the colonial period the rise of manufactures in the Colonies was watched with jealous eyes and regulated by the most stringent laws. The House of Commons declared in I7I9, that the erecting of manufactories in the Colonies tended to lessen their dependence upon Great Britain.

The first notable regulation was that upon the manufacture of woolens. In I699, Parliament enacted that no wool, yarns, cloth, or woolen of American manufacture should be shipped from the Colonies, or even laden in order to be transported from thence to any place whatsoever, under very severe penalties , and it was directed that the Governor of the plantation and the officer of the Customs and Revenue should see that the act was duly executed.

Another act was directed again to the manufacture of hats, an industry for which the Northern Colonies showed an early aptitude. Through the influence of the hatters of London, an act was passed providing that hats could be manufactured in the Colonies only by those who had served an apprenticeship for 7 years, limiting the number of apprentices in the trade, and forbidding the exportation of hat not only to foreign countries, but even their transportation from one plantation to another.

Other act forbade the erection of tee! furnaces, rolling mills, etc. An act of 1750, stated clearly the purpose of these later acts by declaring expressly, that it was intended to encourage the importation of American bar and pig iron and that Great Britain was to be benefited by the exchange of her "woolen and other manufacture " for the bar and pigs imported. In this way, every rising manufacture in the Colonies became the object of regulation and restriction, and its development to any large proportions effectively prevented.

A regulation which effectually prevents the establishment of any manufacture of such commodities for di tant sale, and confine the industries of her Colonies in this way to such coarse and household manufactures, as a private family commonly make for its own use or for some of its neighbors in the same province. The fact that the country was predominantly agricultural, with no manufacture in the modern sense of the term, the manufactured good being supplied by England, and by a wide spread system of self- supporting domestic industries not requiring a large circulating capital and banking accommodation. explain but yet does not fully explain the tardy rise of banking in the Colonies.

In the early history of the colonies the mode of living was of the plainest, and their industries were limited to agriculture, fishing, and the household manufacture of a few of the coarsest articles necessary for existence. Those things which the colonists could not get along without and could not produce for them elves, they imported from England.

It is impossible to a certain the exact number of imports into the Colonies, but English export statistic and the. estimates made by men of the time give a fair idea of the amount. In 1704, the exports from England to North America and to the West Indies amounted to only £483,265, and in the year 1772, the exports to North America and the West Indies amounted to 4,791,734 pounds. At the beginning of the eighteenth century another estimate place the British manufacture and European merchandise, annually received from England, as amounting to nearly four hundred thousand pounds sterling, and toward the close of the colonial period to three million and a half sterling, which was nearly one fourth of the English export trade at those periods.

This extensive business was carried on almost wholly on credit. The goods were in most case imported and sold before return were made to the English merchant. Up to the beginning of the 18th century, before the trade began to assume large proportions, the goods were, as has been shown, hipped here by the merchants and manufacturers and sola for them upon commission, but by the middle of the century, the manner of trade had changed, and few goods were sold upon commission.

The large and well-known merchants al o often recommended for credit smaller merchants in whom they were interested. Not only was it possible for the large and established merchant and those recommended by them to get easy credit on goods purchased, but many of the English merchants encouraged this indebtedness, to assure the continuance of their customers, and to give them certain advantages in their dealing with them, and gave credit to the small merchants, and even directly to the planters themselves, much to the discomfiture of their larger customers.

The Colony trade was conducted so largely on credit, that the colonial merchants, and the English merchant engaged in the Colony trade, came to be absolutely dependent on each other for existence. At the time of the passage of the stamp. Act the debts to the English merchant amounted to several million-pound sterling for good delivered, which the American merchants absolutely refused to pay, pleading as an excuse their inability, which plea the English merchant admitted a reasonable. The colonists were, however, equally dependent on the Eng1ish merchants. Governor Pownall in 1764, wrote that England need have no fear of a revolt of the Conies, for their merchants were and ever must be, in a great measure allied with those of Great Britain, since their very support consisted in this alliance. consisted in this alliance, It is clear therefore, that with the exception of the agricultural and the domestic systems, the industries of the colonies were conducted to a very large extent on foreign capital. Not only were long credits given on goods imported, but in many cases, especially in the South, the warehouses, and even the stores in which · these goods were sold, were the property of English merchants. In many cases also, the goods were imported and sold by English merchant or their factors in person, who remained in the Colonies in order to· be prepared at the proper time to take possession of the planter's crops, if prompt payment were not made. These conditions lessened the necessity in the Colonies of making the best and most systematic use of their own limited capital, and thus removed one of the most effective stimuli for the growth of banking institutions.

This trade would sooner or later, have· demanded banking facilities in the Colonies but here also, as· in the purely British trade, the watchful paternalism of the English merchants served to retard the establishment of banks. The English merchants acted as commission merchant and as bankers for the trade generally. They received consignments from the Colonists and disposed of them on commission. They also received the proceeds of consignments to all parts of the world, and paid the drafts on bills drawn by their colonial correspondents to the order of the British merchants and colonial creditors elsewhere. Almost every American merchant carried an account with some house in England, preferably in London. All his foreign business passed through their hands and the proceeds of his consignments were deposited to the credit of his account. Drafts on these accounts were often honored far in excess of such a limit, the deficiency being covered on the strength of promises of further consignments or shipments of specie. The e accounts showed some very large credits.

The people of the Colonies were so in the habit of looking dependently to the mother country for all kind of services that not only was the banking for the merchant and business men done in England, but even their insurance was for the most part written there. Several attempt at establishing insurance companies in the Colonies had been made, but they met with little success, and it was evidently thought better to obtain in England the needed insurance on vessels engaged in the trans - Atlantic trade. The English merchants also performed to some extent the function of banker for individual in the Colonies, as well as for the business house. These services were rendered indirectly through the colonial merchant.

The merchants were usually the wealthiest members of the community, and they were looked to, not only for credit on goods, but for small advances of money and other banking services. The merchants were the bankers for the Colonists. One of the arguments used against the establishment of banks, was that the merchants would be deprived of the lawful gains of lending their money. Instead of going to a bank as now, the colonist went to his merchant. who on account of his London Connections could make his foreign remittance for him, buy and sell bills of exchange. and perform other banking functions. Hancock did quite an extensive banking business, as is shown by his correspondence. On October 12th, 1764, for example, he notified his agents that since September 24th, he had drawn bills on them in favor of several gentlemen, amounting to 3,668 pounds.

6.5 WHAT TYPES OF BANKS ARE THERE IN THE UNITED STATES?

There are several different types of banking institutions that all work in almost exactly the same way. Before we get into exactly what the banks' function is in the United States, we want to go over the different types of banks you will come across in the country. Keep in mind that the lines aren't drawn with permanent markers here – some banks might offer a variety of services spanning across the different types of banks in our list.

6.5.1 Retail Banks

Retail banks are the ones you come across most often. These banks focus on the consumer and provide the public with a place to deposit money into their own checking and savings accounts.

These kinds of banks give credit cards, offer loans, and offer numerous locations for you to manage your finances.

6.5.2 Commercial Banks

Wikipedia's definition of a commercial bank really hits the nail on the head. Basically, a commercial bank is "an institution that provides services such as accepting deposits, providing business loans, and offering basic investment products."

These banks started out with the aim to serve the business sector and not just the general public. These banks rely on lines of credit to manage cash flow and provide any other kind of service a business might need.

6.5.3 Credit Unions

A credit union is a member-owned financial cooperative, controlled by its members to provide credit at competitive rates. In other words, a credit union is a not-for-profit organization owned by its own customers that offers banking services to its members. Although similar to commercial or retail banks, credit unions differ in that the members share common characteristics like the location of where they live, what occupation they have, and where they work.

6.5.4 Savings Banks

Savings banks provide a place for people to save their money and accrue interest on their money over time

6.5.5 Savings And Loans Associations

Savings and loan associations specialize in accepting savings, deposits, and making mortgages and other loans.

6.5.6 Online Banks

Online banks operate entirely online and do not offer physical brick-and-mortar locations for you to manage your finances at. These are becoming more popular as our world becomes more digitized.

6.5.7 Mutual Banks

Mutual banks are similar to credit unions in that they are owned by the members or customers instead of outside investors.

6.5.8 Central Banks

The central bank is the big dog that manages the monetary system of the government. The Federal Reserve (central bank) is responsible for managing economic activity and supervising banks. You will understand how they do this when you learn how banks function in the next section!

6.6 HOW DO BANKS IN THE UNITED STATES WORK?

Although there are a variety of different kinds of banks, most operate in the same way by doing the same thing. First, you must understand that a bank is a business at the end of the day and that they need to make money too. We explain how below!

6.7 HOW BANKS MAKE MONEY?

Banks in the US make money off of the money you have put into your bank account. Whenever you put money in your account in the United States, that money gets moved to a large pool of money that is used for other people to buy homes, cars, or finance their business or child's education. We get more into this at the end of this section.

6.8 WITHDRAWING MONEY FROM BANKS

Before you freak out about your money getting "taken from you, I want to clarify something. Banks putting your money into this large pool for other people to use does not mean that your money disappears from your control. You can take out the money that has been credited to your account in cash whenever you want. In fact, you can take out as much as you want whenever you want, up to the amount you have put in of course. It is your money, after all. Keep in mind that there are limits to how much money you can take out a day from an ATM, but in general, you can make transactions online and write checks to the amount you desire to withdraw. If you want a certain amount of cash withdrawn from your account, you can always go to a brick-and-mortar bank in your town to request the amount you need from a bank teller. Make sure to take your id and other required documents to take out large sums of money from your account in person.

6.9 BANKING REGULATIONS

Now let’s get back to how banks make money off of your money. Banks create money in the economy that technically wasn’t there before by administering loans. This does not mean that banks are giving out an infinite amount of loans to make more money. This would ruin the economy! There are some regulations set in place to control this.

The Federal Reserve (the central bank mentioned in our list) is what regulates the lending of money by setting reserve requirements that indicate the amount of money banks are allowed to lend. We will paint a picture for you in the following example so you can get a better idea of what we mean.

Let’s say you put $1,000 into your bank account into an American bank account. Of that $1,000 dollars, the bank is allowed to lend out $900 dollars of the total you have put in. Based on this example, what would be the reserve requirement for how much money the bank needs to keep from lending?

Take a second to think about that question.

In other words, what percentage of your deposit did the bank have to keep in its reserve? Ok, now for the answer. If you said 10%, then you guessed the reserve requirement set by the Federal Reserve

Banks are allowed to lend out 90% of your deposit and can not touch 10% of it. The $900 from your $1,000 deposit goes back out into the economy and ends up deposited into another bank. These banks are then able to lend out 90% of the $900 that was put into the account, and on and on, creating an exponentially increasing amount of money in the economy.

Does the Federal Reserve ever change the reserve requirement? That is a great question!

Depending on how the US economy is doing, the Federal Reserve will regulate different metrics (fed tools) to fit the economy’s needs at the time. So if the Federal Reserve lowers the requirement, that means less money will be held onto, consequently pumping more money out into the economy!

The fancy term for this process is called the “expansionary monetary policy”.

If the federal reserve wants to slow economic growth and reduce liquidity (amount of money in the economy), they will raise the requirement so that less money gets put into the economy. The fancy term for that is called a contractionary policy. The lower the requirement, the more money banks get to make off your money because it’s more money they can lend out!

And there you have the hack to how banks make money off your money. Got it? If not, check out more on the Federal Reserve requirement here. This also connects to interest rates which we will get into next.

6.10 WHAT ARE INTEREST RATES?

Interest rates are the key to how banks make more money with your money. Basically, an Interest is how much you are charged for borrowing money, which can be expressed as a percentage of the amount you want to borrow.

For example, if you want to borrow $1,000 in a year at an interest rate of 10%, by the end of the year you would have to pay back the bank the $1,000 plus 10% of the $1,000 you borrowed. This comes out to a repayment of a total of $1,100 by the end of the year.

Ever heard of the term borrowers beware? That is because there is always a cost associated with borrowing something, and that cost can pile up if you are not careful with paying back the money you have borrowed.

Banks graciously lend you money, as long as you pay them back in full with interest! They make you agree to terms that will ensure them they get their money back. What happens if you do not pay the bank back? If you do not pay back on your loans or credit, your credit score will suffer.

6.10.1 Doesn't Sound Like A Big Deal To You?

Well, in the United States it is a huge deal! Having good credit in the United States is extremely important for you to be able to buy homes, cars, and other large sum purchases you will need as you settle down in the country. Do not ruin your credit in the United States!

6.10.2 How Does The Bank Calculate The Interest Rate?

Interest rates among all banks differ and will depend on several variables, including the number of people who want to borrow, and the amount of money the bank is allowed to lend (reserve requirement set by the Federal Reserve – go back to the previous section if you did not get this part).

The amount of money a bank has can also be affected by the interest rate that banks charge each other for short-term loans to meet their reserve requirements. Yes! Banks also borrow money from each other so that they can comply with the Federal reserve requirement.

Banks can also borrow from the central bank itself but usually refrain from doing so because borrowing from the reserve comes at a higher cost than borrowing from regular banks.

Lastly, whatever amount of risk associated with the borrowing you will be doing is directly correlated to the amount will be charged for your interest rate. The riskier the lending is for the bank, the higher the interest rate will be for you. Banks have processes set in place to set interest rates for all different kinds of loans.

6.11 TYPES OF ACCOUNTS YOU WILL USE AT A BANK

The two types of bank account that most consumers get are checking accounts and savings accounts. If you want to learn about the other bank accounts offered by banks, read this.

6.11.1 Checking Accounts

Checking accounts allow you to deposit and withdraw money as frequently as possible. It is the most liquid asset you have at a bank. Once you open a checking account in the United States you will receive a checkbook and a bank card. (Some banks are abstaining from handing out checkbooks for free and will have you pay for them). With these two items, you will be able to make purchases and pay your bills. Depending on the account you get, these kinds of accounts might have minimum monthly balances and service fees to pay. There are plenty of banks without these fees so do your research to find out which one is right for you.

6.11.2 Savings Accounts

Savings accounts also include service fees and monthly minimums and are generally for long-term deposits that you can earn interest on over time. As an international student, you probably will not be needing a savings account because it is for very long-term use. Depending on what you are looking for, however, this could be perfect for you. If you are looking at ways to make money off of your money, we recommend that you look into the stock market or investing in other accounts like mutual funds or even crypto currencies! These are the two types of accounts users generally choose, but ask your bank teller or online bank associate if you might need something else. They are usually very helpful with what you will need.

6.12 SUMMARY

The banking system in United States has changed its shape from time to time according to the requirement of the economy. During the war period the economy requirements forced the money and financial markets towards a drastic change. Due to the failure of exist banking system the authorities required to search for new and innovative methods in the banking system. However, it is note that the British society has great influence on States economy. According to the requirements banks made their regulations.

6.13 TECHNICAL TERMS

Colonial Period
Capital stock
Credit Unions

6.14 SELF ASSESSMENT QUESTIONS

1. Write a note on banking system in the colonial period.
2. What are the reasons forced to establish commercial bank in USA?
3. State the causes for rise of banking institutions in USA.
4. What type of banks are operated in USA?
5. Write a note on banking regulations in USA.

6.15 SUGGESTED READINGS

1. Banking on it – by Annebodern
2. How the other half banks – by MehrsaBaradaran
3. *The Fed Unbound: Central Banking in a Time of Crisis*– by Lev Menand

Dr. K. Sivaji

LESSON -7
UNIT BANKING AND BRANCH BANKING

LEARNING OBJECTIVES

- To get the knowledge about various banking systems
- To understand the nature of the Unit Banking system
- To know the structure and its components of the banking system
- To Understand the role of banks in the economy

STRUCTURE

7.1 INTRODUCTION

Banking is an industry that handles cash, credit, and other financial transactions. Banks provide a Safe place to Store extra cash and credit. They offer savings accounts, Certificates of Deposit, and checking accounts. Banks use these deposits to make loans. These loans include home mortgages, business loans, and car loans. A Bank is a financial institution licensed to receive deposits and make loans. Two of the most common types of banks are commercial/retail and investment banks. Depending on type, a bank may also provide various financial services ranging from providing safe deposit boxes and currency exchange to retirement and wealth management.

7.2 WHAT TYPES OF BANKS ARE THERE IN THE UNITED STATES?

There are several different types of banking institutions that all work in almost exactly the same way. Before we get into exactly what the banks' function is in the United States, we want to go over the different types of banks you will come across in the country. Keep in mind that the lines aren't drawn with permanent markers here – some banks might offer a variety of services spanning across the different types of banks in our list.

7.3 ORIGIN AND DEVELOPMENT OF BANKING

There seem so be no uniformity amongst the economist about the origin of the word 'Bank'. It is believed that the word 'Bank' has been derived from the German word 'Bank' which means joint stock of firm or from the Italian word 'Banco' which means a heap or mound. The development of commercial banking in ancient times was closely associated with the business of money changing. In simple words, bank refers to an institution that deals in money. This institution accepts deposits from the people and gives loans to those who are in need.

7.4 MEANING OF BANKING

We know people earn money to meet their day-to-day expenses on food, clothing, education of children, etc. They also need money to meet future expenses on marriage, higher education of children housing building and social functions. These are heavy expenses, which can be met if some money is saved out of the present income. With this practice, savings were available for use whenever needed, but it also involved the risk of loss by theft, robbery and other accidents. Thus, people were in need of a place where money could be saved safely and would be available when required. Banks are such places where people can deposit their savings with the assurance that they will be able to with draw money from the deposits whenever required. Bank is a lawful organization which accepts deposits that can be withdrawn on demand. It also tends money to individuals and business houses that need it.

Dictionary meaning of the Word 'Bank' -The oxford dictionary defines a bank as "an establishment for custody of money received from or on behalf of its customers. It's essential duty is to pay their drafts on it. It's profits arises from the use of the money left employed by them".

The Webster's Dictionary Defines a bank as "an institution which trades in money, establishment for the deposit, custody and issue of money, as also for making loans and discounts and facilitating the transmission of remittances from one place to another".

The above definitions of bank reveal that bank is a business institution which deals in money and use of money. Thus, a proper and scientific definition of the bank should include various functions performed by a bank in a proper manner. We can say that any person, institution, company or enterprise can be a bank. The business of a bank consists of acceptance of deposits, withdrawals of deposits, making loans and advances, investments on account of which credit is exacted by banks.

Indian Banking Companies Act - "Banking Company is one which transacts the business of banking which means the accepting for the purpose of lending or investment of deposits money from the public repayable on demand or otherwise and withdrawable by cheque, draft, order or otherwise".

7.5 A BRIEF HISTORY OF BANKING OF THE WORLD

Banking activities were sufficiently important in Babylonia in the second millennium B.C. that written standards of practice were considered necessary. These standards were part of the Code of Hammurabi – the earliest known formal laws. Obviously, these primitive banking transactions were very different in many ways to their modern-day counterparts. Deposits were not of money but of cattle, grain or other crops and eventually precious metals. Nevertheless, some of the basic concepts underlying today's banking system were present in these ancient arrangements. A wide range of deposits was accepted, loans were made, and borrowers paid interest to lenders.

Similar banking type arrangements could also be found in ancient Egypt. These arrangements stemmed from the requirement that grain harvests be stored in centralized state warehouses. Depositors could use written orders for the withdrawal of a certain quantity of grain as a means of payment. This system worked so well that it continued to exist even after private banks dealing in coinage and precious metals were established.

We can trace modern-day banking to practices in the Medieval Italian cities of Florence, Venice, and Genoa. The Italian bankers made loans to princes, both to finance wars and their lavish lifestyles, and to merchants engaged in international trade. In fact, these early banks tended to be set up by trading families as a part of their more general business activities. The Bardi and Peruzzi families were dominant in Florence in the 14th century and established branches in other parts of Europe to facilitate their trading activities. Both these banks extended substantial loans to Edward III of England to finance the 100 years war against France.

Banks became an integral part of the US economy from the beginning of the Republic. Five years after the Declaration of Independence, the first chartered bank was established in Philadelphia in 1781, and by 1794, there were seventeen more. At first, bank charters could only be obtained through an act of legislation. But, in 1838, New York adopted the Free Banking Act, which allowed anyone to engage in banking business as long as they met certain legal specifications. As free banking quickly spread to other states, problems associated with the system soon became apparent. For example, banks incorporated under these state laws had the right to issue their own bank notes. This led to a multiplicity of notes – many of which proved to be worthless in the all too common event of a bank failure. With the Civil War came legislation that provided for a federally chartered system of banks. This legislation allowed national banks to issue notes and placed a tax on state issued bank notes. These national bank notes came with a federal guarantee, which protected the note-holder if the bank failed. This new legislation also brought all banks under federal supervision. In essence, it laid the foundations of the present-day system.

7.6 TYPES OF BANKS

There are various types of banks which operate in our country to meet the financial requirements of different categories of people engaged in agriculture, business, profession etc. Banks can be classified into various types on the bases of their functions, ownership, domicile, etc.

7.6.1 Classification On The Basis of Functions

1. **Central Bank:** A central bank functions as the apex controlling institution in the banking and financial system of the country. It functions as the controller of

credit, banker's bank and also enjoys the monopoly of issuing currency on behalf of the government. A central bank is usually control and quite often owned, by the government of a country. The Reserve Bank of India (RBI) is such a bank within an India.

2. **Commercial Banks:** It operates for profit. It accepts deposits from the general public and extends loans to the households, the firms and the government. The essential characteristics of commercial banking are as follows: - Acceptance of deposits from public - For the purpose of lending or investment - Repayable on demand or lending or investment. - Withdrawal by means of an instrument, whether a cheque or otherwise. Another distinguish feature of commercial bank is that a large part of their deposits are demand deposits withdrawable and transferable by cheque.
3. **Industrial Banks:** Industrial banks also known as investment banks mainly meet the medium term and long term financial needs of the industries. The main functions of Industrial banks are:
   i. They accept long term deposits
   ii. They grant long term loans to industrialists to enable them to purchase land, construct factory buildings, purchase heavy buildings, etc.
   iii. They help sell or underwrite the debentures and shares of industrial firms.
   iv. They can also provide information about the general economic position of the economy: Example: Industrial Development bank of India (IDBI); Industrial Finance Corporation of India (IFCI); State Finance Corporations (SFC)
4. **Agricultural Banks:** Agricultural credit needs are different from those of Industry and Trade. The Agriculturists require:
   i. Short term credit to buy seeds, fertilizers and other inputs.
   ii. Long Term credit to purchase land, to make permanent improvements on land, To purchase agricultural machinery and equipment, etc. In India Agricultural Finance is generally provided by co-operative institutions. Agricultural co-operatives provide short-term loans and Land Development banks provide Long term credit to the agriculturists.
5. **Exchange Banks:** Exchange banks Deal in foreign exchange and specialize in financing foreign Trade. They facilitate international payments through the sale and purchase of bills of exchange and thus play an important role in promoting foreign trade.
6. **Savings Bank:** The main Purpose of saving banks is to promote saving habits among the general public and mobilize their small savings. In India, postal saving banks do this job. They open accounts and issue postal cash certificates.
7. **World Bank:** World Bank refers to an institution which provides financial assistance to the member countries of the world. After the world wide depression and World War II, two institutions were founded in 1944,
   i. International Monetary Fund (IMF),
   ii. International Bank of Reconstruction and development (IBRD) or popularly known as the World Bank.

While the IMF was established to provide short-term loans to overcome the balance payments difficulties, the World Bank aimed at providing long term loans for the purpose of reconstructing the war- damaged economies and developing the less developed economies.

7.6.2 Classification On The Basis of Ownership

On the basis of ownership, banks can be classified into three categories:

1. **PUBLIC SECTOR BANKS:** These are owned and controlled by the government: In India, the nationalized banks and the regional rural banks come under these categories.
2. **PRIVATE SECTOR BANKS:** These banks are owned by the private individuals or corporations and not by the government.
3. **CO- OPERATIVE SOCIETIES. CO-OPERATIVE BANKS**: Cooperative banks are operated on the co-operative lines. In India, co-operative credit institutions are organized under the co-operative societies law and play an important role in meeting the financial needs in the rural areas.

7.6.3 Classification On The Basis of Domicile

On the basis of domicile, the banks are divided in to two categories:

1. **Domestic Banks:** These are registered and incorporated within the country.
2. **Foreign Banks:** These are foreign in origin and have their head offices in the country of origin.

7.7 METHODS OF COMMERCIAL BANKING STRUCTURE

The structure of baking is also called organization of baking. It differs from country to another country, depending upon economic and political conditions. Over the years, the structure of banking also has undergone tremendous changes. The following are the several systems of banking.

1. **UNIT BANKING**: Unit banking is a system in which a bank operates in a special area, which is smaller and limited. It operates through a single office and functions within limited resource. Unit banking is often referred to as localized banking. Unit banks may have link with a correspondent bank in the city, this arrangement helps each bank to make remittances through the correspondent banks.
2. **BRANCH BANKING:** Branch banking is a system in which every bank work is a legal entity, having one board of directors and one of shareholders and operates through a network of branches spread throughout the country. The head office of the bank is located in a big city or state capital and the branches operate throughout the country.
3. **GROUP BANKING:** In this system, two or three separately incorporated banks are brought under the control of a holding company. The holding company controls effectively all the units in the group but each bank has a separate entity. The holding company coordinates the activities of the banks of the group. The banks so brought together may be unit banks or branch banks or both.
4. **CHAIN BANKS:** In this system, separately incorporated banks are brought under the common control by a device other than the holding company. For example, some group of persons may own three / four banks or some persons may be directors of several banks. Though a number of banks are brought under common control, each bank in the chain retains the separate entity and carries out the functions without the interference of any body.

5. **CORRESPONDENT BANKING SYSTEM:** It is a system in which unit bank in small towns are linked with big banks in big cities and they act as correspondent banks to several unit banks. It means that the unit banks maintain some deposits with big banks in the metropolitan cities. The correspondent banks provide number of special services to unit banks such as accepting the surplus reserves, remittances facilities to other banks collection of cheques, draft and bills for the unit banks and so on.

7.8 UNIT BANKING SYSTEM

Unit banking is a system in which a bank operates in a special area, which is smaller and limited. It operates through a single office and functions within limited resource. Unit banking is often referred to as localized banking. Unit banks may have link with a correspondent bank in the city. This arrangement helps each bank to make remittances through the correspondent banks.

7.8.1 Advantages of Unit Banking

i) **Local interest:** The unit bank serves the locality much better than the branch bank. It is because the management board of the unit bank can take up the decision on the spot itself. The local officers, who are permanent officers, can take necessary action without waiting for information from the head office.

ii) **Convenience of management, supervision and control:** The size of the bank is very small, its management, supervision and control are very easy. Along with this, wastage and delay, which are inherent weakness of branch banking, can be overcome in unit banking

iii) **Check on the formation of monopolies:** There is a bank for each locality. In this system, there is scope for competition only. Hence, there is no possibility of the growth of monopolies.

iv) **Quick banking services:** The services in unit banking are always quick, because the unit bank need not wait for directions from the central office. There is no delay in taking any decision regarding banking problems.

v) **Initiative in business:** The responsibility of development of banking lies with the bank itself. Therefore, the bank officer takes personal initiative on improving the business of the bank. Since the officers are well acquainted with the local problems, they can take the initiative in solving problems and taking decisions on various issues confronting the bank. This makes the banking system more elastic than what it is under the branch banking system.

vi) **Upholding the local interest:** The unit banks, in principle, are interested in upholding the local interest. The unit banks are mainly interested in the development of industries and agriculture keeping in view the local requirements.

vii) **Other advantages:** Since the unit banks are small when compared to the branch bank, any loss does not cause serious havoc to the credit structure of the country. Since the affairs of the banks are less scattered, there cannot be much of fraud and irregularities. Unit banking is free from diseconomies of large scale operations which are generally associated with branch banking.

7.8.2 Disadvantages of Unit Banking

i) **Inability to finance large-scale development**: One of the most glaring disadvantages of unit banking is the limited financial resources. Consequently, it cannot undertake large scale investment on development activities.

ii) **Absence of division of labour:** The unit banks are so small in size that division of labour is impossible. Consequently, it cannot maintain efficiency. It cannot afford to adopt the latest and the most up-to-date methods of banking.

iii) **Inability to face a financial crisis:** The financial resources of the unit banks are limited. As such, in times of crisis, it fails to face the problem.

iv) **Failure to provide protection to small units:** The unit banks being small are unable to provide full and adequate banking facilities to small units because its area of operations is restricted and does not command adequate resources.

v) **Inconvenience in remittance of funds:** Since the unit bank has no branches elsewhere, remittance of funds becomes very difficult. It therefore depends upon correspondent banks for effecting transfer of funds from one place to another. This makes movement of funds more expensive and inconvenient for businessmen.

vi) **Inequality in interest rates:** Interest rates charged by unit banks are higher than big banks. The interest rates are generally high in backward areas as a matter of great concern. This is due to limited financial resources on one hand and difficulty in the transfer of funds on the other.

vii) **Yielding to influence and pressure:** Many times, the unit bank is forced to ignore economic principle while granting loans. It may be difficult for the bank to refuse an influential local businessman, who may not be so creditworthy. Under unit banking, often loans are given not on pure merit but on consideration of influence and pressures.

7.9 BRANCH BANKING SYSTEM

Branch banking is a system in which every bank work is a legal entity, having one board of directors and one of shareholders and operates through a network of branches spread throughout the country. The head office of the bank is located in a big city or state capital and the branches operate throughout the country. Branch banking has gone through significant changes since the 1980s in response to a more competitive nationwide financial services market. Financial innovation such as internet banking will greatly influence the future of branch banking by potentially reducing the need to maintain extensive branch networks to service consumers.

7.9.1 Advantages of Branch Banking

i. **Large scale operations:** A big bank possessing large financial resources and having a number of branches can specialise in several operations. Huge financial resources enable a bank to provide agriculture and industrial loans to large number of people. It can employ and train officers to carry on increasing responsibilities in the field of financial management, bank can extend its activities all over the country with the presence of efficient staff.

ii. **Geographical spreading of risks:** In the branch banking system, the banks can distribute risks geographically. The banks operating through several branches diversify both deposits and assets. Deposits are mobilized from places where savings are in plenty. At the same time, loans and advances are made to those areas where there is scarcity of capital and interest rates are high. Diversification implies distribution of bank loans to different industries in different areas. There by any risk of loss can be reduced. Even, deposits of small amounts can enjoy the advantage of the services provided by big banks. Branch banking is convenient to operate, since transfer of funds is easy from one branch of a bank to another branch. Again, the financial resources of branch banks are large and can withstand any kind of financial chock and meet any emergency.

iii. **Remittances Facilities:** In the branch banking system, the branches of banks are spread all over the country .As such; it is easier to transfer funds from one branch to another at a lesser cost. This facility is not available in the unit banking system. The unit banks provide the facility of transfer of funds through correspondent banks. But the cost of transfer of funds is high.

iv. **Economy in cash reserves:** A large bank with a number of branches can carry on its lending operations with a small amount of cash reserves. The reason is that the requirements of anyone branch for extra cash can be easily met by transferring cash from some other branch, which happens to possess excess cash reserve. This advantage is deprived to unit banks.

v. **Equality in interest rates**: By mans of transfer of funds from the surplus areas to the deficit areas, uniformity in the interest rates can be maintained.

vi. **Profitable use of funds:** Capital can be profitably employed by means of transferring funds to profitable industries located in port towns/industrial cities. Branch banking ensures greater mobility of funds and profitability of investments.

vii. **Large financial resources:** The great merit of branch banking system ties in mobilizing deposits from all parts of the country .Loans and advances can be made more liberally on a large scale in this system. It is because of the huge deposits branch banks raise that they can diversify their activities.

viii. **Loans and advances and investments on securities:** The branch banks enjoy greater scope in the distribution of assets and thus compromise the twin conflicting principles of liquidity and profitability. The banks can invest in various securities depending on the time of maturity and the interest rates. The branches can also provide loans and advances by discounting trade bills on better terms. The selection of different types of securities imparts a higher degree of safety to the bank.

ix. **Increase in banking facilities**: Since a bank has a number of branches spread all over the country, it can provide increasing banking facilities to the customers, even in remote parts of the country.

x. **Greater public confidence:** A bank with huge financial resources and branches with a wide national network can command greater public confidence than small unit banks.

xi. **Mobilization of deposits:** The success of banking depends upon the facilities to mobilize deposits from different sections of people. Branch banking can not only raise more deposits, but also diversify deposits.

xii. **Efficiency in Management**: Branch banking can ensure maximum efficiency in management. The bank can appoint best men for top management. By providing periodical training, the officers can be made more efficient.

xiii. **High banking standards:** Branch banking can render diversified services to all sorts of customers. Since branch banking has enormous resource, it can introduce advanced banking techniques and thereby maintain high standard of operations.

xiv. **More effective credit control**: Branch banking makes central banking credit control measures more effective and easier than is possible with unit banks.

xv. **Greater contacts:** Under branch banking, the bank can have wide contact with the customers. This helps the bank to acquire correct and reliable knowledge are regards the credit requirements of several segments of the economy. This knowledge helps the bank to plan for profitable investments of surplus funds.

7.9.2 Disadvantages of Branch Banking

i) **Difficulty in management, supervision and control:** If the expansion of the branches go beyond a limit, the administration of branches, supervision of the activities of the branches become difficult. Under expansion results in inefficient management. This also creates red tape, undue delay in decision and in action. For each and everything the branch managers seek direction from the superior officers. Ultimately, the board of management is troubled with not only decision-taking but also its day-to-day administration.

ii) **Possibility of monopoly**: Under branch banking, there is always the possibility of large banks to become monopolies. Emergence of monopoly in banks proves detrimental to the larger interest of the country.

iii) **Unnecessary competition:** The branches of competing banks tempt customers by offering special services and some concession. This naturally increases the expenditure of banks. Unhealthy competition may also result in the lowering of profitability.

iv) **Expensiveness:** Branch banking is highly expensive. Maintenance of branches with several officers and supervisors for control is very expensive. They also nave spend considerable sums of money for advertisement. All these lead more expenses. The cost of control also becomes prohibitive.

v) **Continuance of non-profitable branches:** The branches in many business places may work profitably, but the branches in residential localities and rural places may not get sufficient profitable business. As a result, the head office of the bank has to run non-profitable branches forcibly.

vi) **Savings of rural places are transferred to urban places for investments:** Normally, the excess of deposits mobilized in rural branches are transferred to branches in big cities for investment. Investment opportunities are denied in the rural areas. Banks consider that investment of funds in bigger cities and towns are more profitable than in smaller places and backward areas. This hinders economic development of backward areas.

7.10 MIXED BANKING

Mixed banking is that system of banking under which the commercial banks perform the dual function of commercial banking and investment banking, i.e., it combines deposit and lending activity with investment banking. Commercial banks usually offer both short-term as well as medium term loans. The German banking system is the best example of mixed Banking where banks are permitted besides, lending activity, investment functioning also. In India, Banks are permitted to undertake limited investment activity. In USA commercial or credit banks are not permitted to undertake investment activity. Banks in Switzerland, Denmark, Japan also provide long-term loans.

7.10.1 The Need for Mixed Banking

1. The need for industrial revival was felt both by the government and the banks. Many industrial units to which the banks had supplied short-term loans were not in a position to repay. So the bank took a wise step to take debentures of such companies in view of short-term loans instead of writing them off.
2. The deposits of commercial banks were fast increasing it was advisable for the banks to advance loans for long periods.
3. The growth of big industries led to a decrease in the dependence of bank finance as they built up their own surplus funds to supplement their working capital. Thus, banks were deprived of their best customers. So, they were compelled to grant long-term loans to big industries and gradually start holding industrial securities.
4. The government policy was for quick industrialization in countries like Germany and Japan. Bank undertook the responsibility of supplying long-term finance to industries for speedy industrialization.
5. Stock exchange was increased for the marketability of securities of joint stock companies. The bank companies as they could sell them in the stock exchange at any time and convert them into cash.

7.10.2 Merits of Mixed Banking System

1. By providing both short term and long term finance to Industries mixed banking leads to rapid Industrialization of a country.
2. Industry concerns have the advantage of receiving the expert advice and guidance of the banks on various financial matters.
3. Mixed banking enables the commercial banks to utilize their funds more profitably as they have two lines of business viz 1. Commercial banking business 2. Industrial Banking business.
4. Participation of commercial banks in the financing of Industries concerns creates greater confidence among the investing public and thereby industrial concerns can secure large finance from the public.

7.10.3 Demerits of Mixed Banking System

1. It reduces the liquidity of funds of commercial banks and thereby reduces the ability of commercial banks to repay the debt of their customers on demand.
2. If the industry to which a bank has lent large amount fails the profitability of the bank also will be adversely affected.
3. In times of depression, the value of industrial sector falls down considerably. As a result, the commercial banks invested their funds on shares and debentures of industries concern have to suffer huge losses.
4. In times of boom, commercial banking is tempted to invest their funds in Industrial sector beyond safe limits.
5. Through their rep on the boards of management of Industrial concerns financed by them, commercial banks exercise direct and considerable influence on the industries. As a result, industrial concerns find their freedom of action restricted.

7.11 KEY DIFFERENCES BETWEEN UNIT BANKING AND BRANCH BANKING

The points given below explain the difference between unit banking and branch banking in detail:

1. Unit banking is a type of banking system adopted in many countries wherein there is a single independent small bank that caters a particular locality. On the other hand, branch banking can be defined as a banking practice wherein a bank has several branches that operate throughout the country and even in foreign countries, to provide services to its customers.
2. While unit banks are not influenced by ups and downs of the local economy, branch banks remain unaffected by the ups and downs of the local economy, however, they are hit by the changes in the national economy.
3. A unit bank has more independence of operations, as compared to the branch bank.
4. When it comes to supervision cost, it is higher in case of a unit bank than a branch bank.
5. A branch bank has a large pool of financial resources, at its disposal. Conversely, in a unit banking system, the financial resources are limited to the particular unit only.
6. If we talk about competition, there is a high level of competition between the bank branches to sell its products and provide services to the customers. On the contrary, in the unit banking system, the competition hardly exists within the bank.
7. In the unit banking system, the rate of interest is not fixed as the unit bank has its own policies and guidelines. As against, in a branch banking, the interest rate is decided by the head office, as per the directions of the central bank.
8. As a unit bank is an independent one, it does not need to rely on any other body for taking important decisions. In contrast, in a branch banking system, the decision making is time-consuming, as it has to rely on the head office.

7.12 HOW DO BANKS IN THE UNITED STATES WORK?

Although there are a variety of different kinds of banks, most operate in the same way by doing the same thing. First, you must understand that a bank is a business at the end of the day and that they need to make money too. We explain how below!

7.13 HOW BANKS MAKE MONEY?

Banks in the US make money off of the money you have put into your bank account. Whenever you put money in your account in the United States, that money gets moved to a large pool of money that is used for other people to buy homes, cars, or finance their business or child's education. We get more into this at the end of this section.

7.14 WITHDRAWING MONEY FROM BANKS

Before you freak out about your money getting "taken from you, I want to clarify something. Banks putting your money into this large pool for other people to use does not mean that your money disappears from your control. You can take out the money that has been credited to your account in cash whenever you want. In fact, you can take out as much as you want whenever you want, up to the amount you have put in of course. It is your money, after all. Keep in mind that there are limits to how much money you can take out a day from an ATM, but in general, you can make transactions online and write checks to the amount you desire to withdraw. If you want a certain amount of cash withdrawn from your account, you can always go to a brick-and-mortar bank in your town to request the amount you need from a bank teller. Make sure to take your id and other required documents to take out large sums of money from your account in person.

7.15 BANKING REGULATIONS

Now let's get back to how banks make money off of your money. Banks create money in the economy that technically wasn't there before by administering loans. This does not mean that banks are giving out an infinite amount of loans to make more money. This would ruin the economy! There are some regulations set in place to control this.The Federal Reserve (the central bank mentioned in our list) is what regulates the lending of money by setting reserve requirements that indicate the amount of money banks are allowed to lend. We will paint a picture for you in the following example so you can get a better idea of what we mean.

Let's say you put $1,000 into your bank account into an American bank account. Of that $1,000 dollars, the bank is allowed to lend out $900 dollars of the total you have put in. Based on this example, what would be the reserve requirement for how much money the bank needs to keep from lending?

Banks are allowed to lend out 90% of your deposit and can not touch 10% of it. The $900 from your $1,000 deposit goes back out into the economy and ends up deposited into another bank. These banks are then able to lend out 90% of the $900 that was put into the account, and on and on, creating an exponentially increasing amount of money in the economy.

Does the Federal Reserve ever change the reserve requirement? That is a great question!

Depending on how the US economy is doing, the Federal Reserve will regulate different metrics (fed tools) to fit the economy's needs at the time. So if the Federal Reserve lowers the requirement, that means less money will be held onto, consequently pumping more money out into the economy. The fancy term for this process is called the "expansionary monetary policy".

If the federal reserve wants to slow economic growth and reduce liquidity (amount of money in the economy), they will raise the requirement so that less money gets put into the economy. The fancy term for that is called a contractionary policy. The lower the requirement, the more money banks get to make off your money because it's more money they can lend out!

And there you have the hack to how banks make money off your money. Got it? If not, check out more on the Federal Reserve Requirement here. This also connects to interest rates which we will get into next.

7.16 WHAT ARE INTEREST RATES?

Interest rates are the key to how banks make more money with your money. Basically, an Interest is how much you are charged for borrowing money, which can be expressed as a percentage of the amount you want to borrow.

For example, if you want to borrow $1,000 in a year at an interest rate of 10%, by the end of the year you would have to pay back the bank the $1,000 plus 10% of the $1,000 you borrowed. This comes out to a repayment of a total of $1,100 by the end of the year.

Ever heard of the term borrowers beware? That is because there is always a cost associated with borrowing something, and that cost can pile up if you are not careful with paying back the money you have borrowed. Banks graciously lend you money, as long as you pay them back in full with interest! They make you agree to terms that will ensure them they get their money back. What happens if you do not pay the bank back? If you do not pay back on your loans or credit, your credit score will suffer.

7.17 SUMMARY

The banking system in United States has changed its shape from time to time according to the requirement of the economy. Various banking systems are generated and operated in the United States economy and print its own standards on the economy. In crucial time Unit banking system initiated and successfully organized in the United States.

7.18 KEY WORDS

Industrial bank
Fed tools
Banking regulations
Mixed Banking

7.19 SELF - ASSESSMENT QUESTIONS

1. What are the different methods of banking structure?
2. Classify the banks based on its functions
3. What are the advantages and disadvantages with Unit Banking system?
4. What are the advantages of Mixed Banking System?

7.20 FURTHER READINGS

1. The Little Markets: The Story of Unit Banks - Ranajoy Ray Chaudhuri
2. The Economics and Politics of Unit Banking - Marcus M. Witcher
3. Branch versus Unit Banking: Bank Output and Cost Economies - John Anthony Powers

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Lesson – 8
NEW YORK MONEY MARKET

LEARNING OBJECTIVES

To know the concept of money market
To get the information about origin and growth of money market
To know the strengths and weaknesses of US monetary system
To examine the role of various components of the system

STRUCTURE

8.1 INTRODUCTION TO THE MONEY MARKET OF USA

The domestic money market in the United States of America carries out the largest volume of transactions of any such market in the world; its participants include the most heterogeneous group of financial and nonfinancial concerns to be found in any money market; it permits trading in an unusually wide variety of money substitutes; and it is less centralized geographically than the money market of any other country. Although there has always been a clustering of money market activities in New York City and much of the country's participation in the international money market centres there, a process of continuous change during the 20th century has produced a genuinely national money market.

By 1935 the financial crises of the Great Depression had resulted in a basic revision of the banking laws. All gold had been withdrawn from internal circulation in 1933 and was henceforth held by the U.S. Treasury for use only in settling net flows of international payments among governments or central banks; its price was raised to $35 per ounce, and the U.S. dollar became the key currency in an international gold bullion standard. Domestically, the changes included legislative recognition of the primary importance of unified open-market operations by the Federal Reserve System and delegation to the board of governors of the Federal Reserve System of authority to raise or lower the ratios required between reserves and Commercial Bank deposits. Although about half of the 30,000 separate banks existing in the early 1920s had disappeared by the mid-1930s, the essential character of commercial banking in the U.S. remained that of a “unit” (or single-outlet) banking system in contrast to those of most other countries, which had a small number of large branch-banking organizations.

8.2 THE UNIT BANKING SYSTEM

This system has led inevitably to striking differences between money market arrangements in the United States and those of other countries. At times, some smaller banks almost inevitably find that the wholesale facilities of the money market cannot provide promptly the funds needed to meet unexpected reserve drains, as deposits move about the country from one bank to another. To provide temporary relief, pending a return flow of funds or more gradual disposal of other liquid assets in the money market, such banks have the privilege, if they are members of the Federal Reserve System, of borrowing for reasonable periods at their own Federal Reserve bank.

At times some large banks, which serve as depositories for part of the liquid balances of many of the smaller ones (including those that are not members of the Federal Reserve System) also find that demands converging on them are much greater than expected. These large banks, too, can borrow temporarily at a Federal Reserve bank if other money market facilities are not adequate to their needs. Because these borrowing needs are unavoidably frequent in a vast unit banking system and, as a rule, do not indicate poor management, the discount rate charged by the Federal Reserve banks on such borrowing is not ordinarily put at punitive or severe penalty levels—thus, contrary to practice in many other countries, the central bank does not always maintain its interest rate well above those prevailing on marketable money market instruments. To avoid abuse, there is continuous surveillance of the borrowing banks by the Federal Reserve banks.

Along with this practice of borrowing at a Federal Reserve bank has developed the market for “**federal funds**.” This specialized part of the money market provides for the direct transfer to a member bank of balances on the books of a Federal Reserve bank in return for payment of a variable rate of interest called the “federal funds rate.” These funds are immediately available. There are transactions, too, in funds that are on deposit at commercial banks—by means of loans between banks, or through loans by one large depositor to another. Because these must be collected through a clearing process, they are usually called “clearing house “funds.

8.3 MONEY MARKET INSTRUMENTS

Transactions in federal funds and clearinghouse funds are further supplemented by transactions in which either kind of money is exchanged for some other liquid, money market instrument, most frequently government securities. The magnitude of the market for government securities became so great after World War II that it overshadowed all other elements of the money market. Trading in outstanding “governments” is virtually all done through dealers who buy and sell for their own account at prices which they quote on request (standing ready to “bid” for or to “offer” any outstanding issue). Most of these dealers have head offices located in New York City, but all are engaged in nationwide operations. Their transactions and the lending arrangements through which they finance their own inventories of government securities have evolved into a particularly sensitive indicator of the pressures of supply and demand on the money market from day to day. The most common form of dealer financing is the repurchase agreement, through which dealers sell parts of their inventory temporarily, subject to repurchase.

Closely interrelated, often through trading operations conducted by the same dealers, are the much smaller markets for bank drafts, bills of exchange, and commercial paper. Alongside these other markets and actually somewhat larger in outstanding volume are the markets for securities issued by various "agencies" created by federal statute, such as the Federal Home Loan banks and Federal Land banks. Another money market instrument is the negotiable time Certificate of Deposit (CD), issued in large volume by commercial banks, which first became significant in 1962. While the owner of a time CD cannot withdraw his deposit before the maturity date initially agreed upon, he can sell it at any time in a secondary market that is conducted by government securities dealers.

The Federal Reserve System conducts day-to-day operations in the money market on its own initiative in order to assist the smooth working of the nation's financial machinery and to exert a general influence aimed at fostering economic growth and limiting economic instability. Its transactions include substantial outright purchases or sales of government securities, relatively small purchases and run-offs of bankers' acceptances, and a considerable volume of loans made for a few days at a time to dealers in government securities or acceptances in the form of repurchase agreements. While it is still the commercial banks as a group that have the greatest continuing need for the combined facilities of the nationwide money market, there is frequent and continuous participation by a great variety of institutional investors who channel the public's savings into various uses and who must always also make some provision for their own liquidity.

Perhaps the most unusual feature in the composition of the U.S. money market is the great importance attained by nonfinancial business concerns and local units of government since World War II. Corporate treasurers and the treasurers of many states and local political subdivisions and authorities have become so keenly sensitive to the profitable possibilities of managing their own liquid holdings instead of relying on the commercial banks as most had done formerly that this group at times provides nearly as large a part of the volatile financing needs of government securities dealers, for example, as comes from the banks. Moreover, banks outside New York City sometimes supply more of the financing needed by these dealers than do the traditional "money market banks" in the New York City. The nationwide character of the money market is also shown by the participation of nearly 200 banks in the federal-funds market—banks that are widely scattered among all Federal Reserve districts, although the bulk of all transactions is executed through facilities located in New York.

While the U.S. money market has become truly national, it still needs a final clearing centre upon which the net impact of changes in overall supply or demand can ultimately converge and where the final balancing adjustments of the market as a whole can be accomplished. In filling that need, New York City continues to be the centre of the national money market.

8.4 GREAT DEPRESSION IN USA AND THE WORLD

The "Great Depression " was a severe, world -wide economic disintegration symbolized in the United States by the stock market crash on "Black Thursday", October 24, 1929. The causes of the Great Depression were many and varied, but the impact was visible across the country. By the time that FDR was inaugurated president on March 4, 1933, the banking system had collapsed, nearly 25 per cent of the labour force was unemployed, and prices and productivity had fallen to 1/3 of their 1929 levels. Reduced prices and reduced output resulted in lower incomes in wages, rents, dividends, and profits throughout the economy. Factories were shut down, farms and homes were lost to foreclosure, mills and mines were abandoned, and people went hungry. The resulting lower incomes meant the further inability of the people to spend or to save their way out of the crisis, thus perpetuating the economic slowdown in a seemingly never-ending cycle.

8.4.1 Interesting Facts about the Great Depression

- The stock market lost almost 90 per cent of its value between 1929 and 1933.
- Around 11,000 banks failed during the Great Depression, leaving many with no savings.
- In 1929, unemployment was around 3%. In 1933, it was 25 per cent, with 1 out of every 4 people out of work.
- The average family income dropped by 40 per cent during the Great Depression.
- More than $1 billion in bank deposits were lost due to bank closings.
- The New Deal created around 100 new government offices and 40 new agencies.
- The worst years of the Great Depression were 1932 and 1933.
- Around 300,000 companies went out of business.
- Hundreds of thousands of families could not pay their mortgages and were evicted from their homes.
- Millions of people migrated away from the Dust Bowl region in the Midwest. Around 200,000 migrants moved to California.
- President Roosevelt pushed 15 major laws through in his "First Hundred Days" of office.

8.4.2 How Did It Start?

The Great Depression began with the crash of the stock market in October of 1929. Historians and economists give various causes for the Great Depression including drought, overproduction of goods, bank failures, stock speculation, and consumer debt.

8.5 WHAT CAUSED THE GREAT DEPRESSION?

1. Economists continue to study the Great Depression because they still disagree on what caused it. Many theories have been advanced over the years, but there remains no single, universally agreed-upon explanation as to why the Depression happened or why the economy eventually recovered.
2. The 1929 stock market crash often comes to mind first when people think about the Great Depression. The crash destroyed considerable wealth. Perhaps even more important, the crash sparked doubts about the health of the economy, which led consumers and firms to pull back on their spending, especially on big-ticket

items like cars and appliances. However, as big as it was, the stock market crash alone did not cause the Great Depression.

3. Some economists point a finger at protectionist trade policies and the collapse of international trade. The Smoot-Hawley tariff of 1930 dramatically increased the cost of imported goods and led to retaliatory actions by the United States' major trading partners. The Great Depression was a worldwide phenomenon, and the collapse of international trade was even greater than the collapse of world output of goods and services. Still, like the stock market crash, protectionist trade policies alone did not cause the Great Depression.
4. Other experts offer different explanations for the Great Depression. Some historians have called the Depression an inevitable failure of capitalism. Others blame the Depression on the "excesses" of the 1920s: excessive production of commodities, excessive building, excessive financial speculation or an excessively skeweddistribution of income and wealth. None of these explanations has held up very well over time. One explanation that has stood the test of time focuses on the collapse of the U.S. banking system and resulting contraction of the nation's money stock. Economists Milton Friedman and Anna Schwartz make a strong case that a falling money stock caused the sharp decline in output and prices in the economy.
5. As the money stock fell, spending on goods and services declined, which in turn caused firms to cut prices and output and to lay off workers. The resulting decline in incomes made it harder for borrowers to repay loans. Defaults and bankruptcies soared, creating a vicious spiral in which more banks failed, the money stock contracted further, and output, prices and employment continued to decline.

8.6 MONEY, BANKING AND DEFLATION

- Money makes the economy function. Money evolved thousands of years ago because barter—the direct trading of goods or services for other goods or services—simply didn't work. A modern economy could not function without money, and economies tend to break down when the quantity or value of money changes suddenly or dramatically. Print too much money, and its value declines—that is, prices rise (inflation). Shrink the money stock, on the other hand, and the value of money rises—that is, prices fall (deflation).
- In modern economies, bank deposits—not coins or currency—comprise the lion's share of the money stock. Bank deposits are created when banks make loans, and deposits contract when customers repay loans. The amount of loans that banks can make, and hence the quantity of deposits that are created, is determined partly by regulations on the number of reserves that banks must hold against their deposits and partly by the business judgment of bankers.
- In the United States, bank reserves consist of the cash that banks hold in their vaults and the deposits they keep at Federal Reserve banks. Reserves earn little or no interest, so banks don't like to hold too much of them. On the other hand, if banks hold too few reserves, they risk getting caught short in the event of unexpected deposit withdrawals.
- In the 1930s, the United States was on the gold standard, meaning that the U.S. government would exchange dollars for gold at a fixed price. Commercial banks, as well as Federal Reserve banks, held a portion of their reserves in the form of gold coin and bullion, as required by law.

- An increase in gold reserves, which might come from domestic mining or inflows of gold from abroad, would enable banks to increase their lending and, as a result, would tend to inflate the money stock. A decrease in reserves, on the other hand, would tend to contract the money stock. For example, large withdrawals of cash or gold from banks could reduce bank reserves to the point that banks would have to contract their outstanding loans, which would further reduce deposits and shrink the money stock.
- The money stock fell during the Great Depression primarily because of banking panics. Banking systems rely on the confidence of depositors that they will be able to access their funds in banks whenever they need them. If that confidence is shaken—perhaps by the failure of an important bank or large commercial firm—people will rush to withdraw their deposits to avoid losing their funds if their own bank fails.
- Because banks hold only a fraction of the value of their customers' deposits in the form of reserves, a sudden, unexpected attempt to convert deposits into cash can leave banks short of reserves. Ordinarily, banks can borrow extra reserves from other banks or from the Federal Reserve. However, borrowing from other banks becomes extremely expensive or even impossible when depositors make demands on all banks. During the Great Depression, many banks could not or would not borrow from the Federal Reserve because they either lacked acceptable collateral or did not belong to the Federal Reserve System.
- Starting in 1930, a series of banking panics rocked the U.S. financial system. As depositors pulled funds out of banks, banks lost reserves and had to contract their loans and deposits, which reduced the nation's money stock. The monetary contraction, as well as the financial chaos associated with the failure of large numbers of banks, caused the economy to collapse.
- Less money and increased borrowing costs reduced spending on goods and services, which caused firms to cut back on production, cut prices and lay off workers. Falling prices and incomes, in turn, led to even more economic distress. Deflation increased the real burden of debt and left many firms and households with too little income to repay their loans. Bankruptcies and defaults increased, which caused thousands of banks to fail. In each year from 1930 to 1933, more than 1,000 U.S. banks closed.
- Banking panics are pretty much a thing of the past, thanks to federal deposit insurance. Widespread failures of banks and savings institutions during the 1980s did not cause depositors to panic, which limited withdrawals from the banking system and prevented serious reverberations throughout the economy.

8.7 THE MONEY MARKET

The term money market is actually a misnomer. Money—currency—is not traded in the money markets. Because the securities that do trade there are short-term and highly liquid, however, they are close to being money. Money market securities, which are discussed in detail here, have three basic characteristics in common:

- They are usually sold in large denominations.
- They have low default risk.
- They mature in one year or less from their original issue date.

Money market transactions do not take place in any one particular location or building. Instead, traders usually arrange purchases and sales between participants over the phone and complete them electronically. Because of this characteristic, money market securities usually have an active secondary market. This means that after the security has been sold initially, it is relatively easy to find buyers who will purchase it in the future. An active secondary market makes money market securities very flexible instruments to use to fill short-term financial needs. For example, Microsoft's annual report states, "We consider all highly liquid interest-earning investments with a maturity of 3 months or less at date of purchase to be cash equivalents." Another characteristic of the money markets is that they are wholesale markets. This means that most transactions are very large, usually in excess of $1 million. The size of these transactions prevents most individual investors from participating directly in the money markets. Instead, dealers and brokers, operating in the trading rooms of large banks and brokerage houses, bring customers together. These traders will buy or sell $50 or $100 million in mere seconds—certainly not a job for the faint of heart.

Flexibility and innovation are two important characteristics of any financial market, and the money markets are no exception. Despite the wholesale nature of the money market, innovative securities and trading methods have been developed to give small investors access to money market securities. We will discuss these securities and their characteristics later in the chapter, and again in Chapter 20, where we show how they are used by the mutual fund industry.

8.8 WHY DO WE NEED THE MONEY MARKETS?

In a totally unregulated world, the money markets should not be needed. The banking industry exists primarily to provide short-term loans and to accept short-term deposits. Banks should have an efficiency advantage in gathering information, an advantage that should eliminate the need for the money markets. Thanks to continuing relationships with customers, banks should be able to offer loans more cheaply than diversified markets, which must evaluate each borrower every time a new security is offered. Furthermore, short-term securities offered for sale in the money markets are neither as liquid nor as safe as deposits placed in banks and thrifts. Given the advantages that banks have, why do the money markets exist at all? banking industry exists primarily to mediate the asymmetric information problem between saver-lenders and borrower-spenders, and banks can earn profits by capturing economies of scale while providing this service. However, the banking industry is subject to more regulations and governmental costs than are the money markets. In situations where the asymmetric information problem is not severe, the money markets have a distinct cost advantage over banks in providing short-term funds.

8.9 THE PURPOSE OF THE MONEY MARKETS

The well-developed secondary market for money market instruments makes the money market an ideal place for a firm or financial institution to "warehouse" surplus funds until they are needed. Similarly, the money markets provide a low-cost source of funds to firms, the government, and intermediaries that need a short-term infusion of funds. The goal of most investors in the money market who are temporarily warehousing funds is not to earn particularly high returns on their funds. Rather, they use the money market as an interim investment that provides a higher return than holding cash or money in banks. They may feel that market conditions are not right to war-rant the purchase of additional stock, or they may expect interest rates to rise and hence not want to purchase bonds. It is important to keep in mind that holding idle surplus cash is expensive for an investor because cash balances earn no income for the owner. Idle cash represents an opportunity cost in terms of lost interest income. Recall from Chapter 4 that an asset's opportunity cost is the amount of interest sacrificed by not holding an alternative asset. The money markets provide a means to invest idle funds and to reduce this opportunity cost.Investment advisers often hold some funds in the money market so that they will be able to act quickly to take advantage of investment opportunities they might identify. Most investment funds and financial intermediaries also hold money market securities to meet investment or deposit outflows. The sellers of money market securities find that the money market provides a low-cost source of temporary funds. For example, banks may borrow excess reserves (we will define the money market securities later in this chapter) to obtain funds in the money market to meet short-term reserve requirement shortages. The government funds a large portion of the U.S. debt with Treasury bills. Finance companies like GMAC (General Motors Acceptance Company) may enter the money market to raise the funds that it uses to make car loans.

Why do corporations and the U.S. government sometimes need to get their hands on funds quickly? The primary reason is that cash inflows and outflows are rarely synchronized. Government tax revenues, for example, usually come only at certain times of the year, but expenses are incurred all year long. The government can borrow short-term funds that it will pay back when it receives tax revenues.

8.10 WHO PARTICIPATES IN THE MONEY MARKETS?

An obvious way to discuss the players in the money market would be to list those who borrow and those who lend. The problem with this approach is that most money market participants operate on both sides of the market. For example, any large bank will borrow aggressively in the money market by selling large commercial CDs. At the same time, it will lend short-term funds to businesses through its commercial lending departments. Nevertheless, we can identify the primary money market players—the U.S. Treasury, the Federal Reserve System, commercial banks, businesses, investments and securities firms, and individuals—and discuss their roles.

8.10.1 U.S. Treasury Department

The U.S. Treasury Department is unique because it is always a demander of money market funds and never a supplier. The U.S. Treasury is the largest of all money market borrowers worldwide. It issues Treasury bills (often called T-bills) and other securities that are popular with other money market participants. Short-term issues enable the government to raise funds until tax revenues are received. The Treasury also issues T-bills to replace maturing issues.

8.10.2 Federal Reserve System

The Fed holds vast quantities of Treasury securities that it sells if it believes interest rates should be raised. Similarly, the Fed will purchase Treasury securities if it believes interest rates should be lowered. The Fed's responsibility for interest rates makes it the most influential participant in the U.S. money market. The Federal Reserve's role in controlling the economy through open market operations.

8.10.3 Commercial Banks

Commercial banks hold a percentage of U.S. government securities second only to pension funds. This is partly because of regulations that limit the investment opportunities available to banks. Specifically, banks are prohibited from owning risky securities, such as stocks or corporate bonds. There are no restrictions against holding Treasury securities because of their low risk and high liquidity. Banks are also the major issues of negotiable certificates of deposit (CDs), bankers acceptances, federal funds, and repurchase agreements (we will discuss these securities in the next section). In addition to using money market securities to help manage their own liquidity, many banks trade on behalf of their customers. Not all commercial banks deal in the secondary money market for their customers. The ones that do are among the largest in the country and are often referred to as money centre banks. The biggest money centre banks include Citigroup, Bank of America, J.P. Morgan, and Wells Fargo.

8.10.4 Businesses

Many businesses buy and sell securities in the money markets. Such activity is usually limited to major corporations because of the large dollar amounts involved. As discussed earlier, the money markets are used extensively by businesses both to warehouse surplus funds and to raise short-term funds. We will discuss the specific money market securities that businesses issue later in this chapter

8.10.5 Investment And Securities Firms

The other financial institutions that participate in the money markets are listed in Investment Companies Large diversified brokerage firms are active in the moneymarkets. The largest of these include Bank of America, Merrill Lynch, Barclays Capital, Credit Suisse, and Goldman Sachs. The primary function of these dealers is to “make a market” for money market securities by maintaining an inventory from which to buy or sell. These firms are very important to the liquidity of the money market because they ensure that sellers can readily market their securities. We discuss investment

8.10.6 Finance Companies

Finance companies raise funds in the money marketprimarily by selling commercial paper. They then lend the funds to consumers for the purchase of durable goods such as cars, boats, and home improvements.

8.10.7 Insurance Companies

Property and casualty insurance companies must maintain liquidity because of their unpredictable need for funds. For example, when tornadoes and flooding hit the Midwest in December 2015, more than 1,000 homes were destroyed and 50 lives lost. Insurance companies paid out over a billion dollars in benefits to policyholders. To meet this demand for funds, the insurance companies sold some of their money market securities to raise cash.

8.10.8 Pension Funds

Pension funds invest a portion of their cash in the money markets so that they can take advantage of investment opportunities that they may identify in the stock or bond markets.

Like insurance companies, pension funds must have sufficient liquidity to meet their obligations. However, because their obligations are reasonably predictable, large money market security holdings are unnecessary.

8.10.9 Individuals

When inflation rose in the late 1970s, the interest rates that banks were offering on deposits became unattractive to individual investors. At this same time, brokerage houses began promoting money market mutual funds, which paid much higher rates.

Due to regulations that capped the rate they could pay on deposits, banks could not stop large amounts of cash from moving to mutual funds. To combat this flight of money from banks, the authorities revised the regulations. Banks quickly raised rates in an attempt to recapture individual investors' dollars. This halted the rapid movement of funds, but money market mutual funds remain a popular individual investment option. The advantage of mutual funds is that they give investors with relatively small amounts of cash access to large-denomination securities.

8.11 SUMMARY

The money market of United States of America showing that several fluctuations in the history. Different players are gaming the tasks which are not neglectable. The role of central banking is very vital and the same part of importance maintained by the commercial banks. Interest rate and flow of funds are controlling the current situations.

8.12 KEY WORDS

Industrial bank
Treasury department
Pension funds
Stock fell
Great depression
Dust Bow

8.13 SELF - ASSESSMENT QUESTIONS

1. Who are the prime participants to the money market?
2. What are the functions of money markets?
3. What are the causes of great depression in USA?
4. Write a note on growth of US money market.
5. What is the importance of money markets?

8.14 FURTHER READINGS

1. The Money Markets Handbook: A Practitioner's Guide – by Released January.
2. The Money Market - by F. Straker
3. Money and Banking – by Robert E. Wright, NYU
4. The Economics and Politics of Unit Banking - Marcus M. Witcher

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LESSON-9
EUROPEAN MONETARY UNION (EMU)

AIMS AND OBJECTIVES

After studying this lesson student should be able to

- Know about the European Monetary Union
- Understand for History of Economic and monetary union (EMU)
- Explain the Role of the European Parliament
- Awareness regarding The Bank of England (BoE)

STRUCTURE

9.1. INTRODUCTION

A monetary union was established in 1999 and came into full force in 2002 and is composed of 19 EU member states which use the euro currency. These are Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Portugal, Slovakia, Slovenia, and Spain.

Euro zone: All 20 EMU countries have adopted the euro as their currency. Outside the EU, other countries have the euro as their official currency. In Europem these are Andorra, Kosovo, Monaco, Montenegro, San Marino and Vatican City. In addition, some dependent territories of EU states have adopted the euro, but some are neither EU nor EMU members. These are, for example, the Dutch and French overseas territories in the Caribbean, the Indian Ocean and the Pacific.

Common economic objectives: The common goal of the union is the further development and stabilization of the European internal market. One of the union's primary objectives is to maintain the price level and currency stability of the euro. All states of the European Union participate in the economic union, but not in the monetary union. In other words, Bulgaria, Denmark, Croatia, Poland, Romania, Sweden, the Czech Republic and Hungary also participate. These countries are exempted from EMU, but do not yet have to complete the third stage of the introduction of the euro.

Entry Criteria: The basic prerequisite for admission to EMU is membership in the European Union. Even financially strong and stable countries outside the EU cannot become Alliance members. In addition, strict conditions are imposed on the economy of a candidate country. For example, the inflation rate must not be lower than 1.5 percent of the most price stable EMU country. The country must not have more than 60 percent debt and new debt must be below 3 percent. It should be noted that these are admission criteria. If a member state no longer meets these criteria after admission, it does not automatically drop out. The question as to whether, for example, Greece could be excluded from EMU by force because it no longer fulfilled the admission criteria has so far remained unanswered

Country	Commencement	Population	Area	GDP
Austria	1999	8.96 M	84,000 km^2	480.37 bn US$
Belgium	1999	11.59 M	31,000 km^2	594.10 bn US$
Croatia	2023	3.90 M	57,000 km^2	68.96 bn US$
Cyprus	2008	1.24 M	9,250 km^2	28.41 bn US$
Estonia	2011	1.33 M	45,000 km^2	37.19 bn US$
Finland	1999	5.54 M	338,000 km^2	297.30 bn US$
France	1999	67.75 M	549,000 km^2	2.958 tn US$
Germany	1999	83.20 M	358,000 km^2	4.260 tn US$
Greece	2001	10.64 M	132,000 km^2	214.87 bn US$
Ireland	1999	5.03 M	70,000 km^2	504.18 bn US$
Italy	1999	59.11 M	301,000 km^2	2.108 tn US$
Latvia	2014	1.88 M	64,000 km^2	39.85 bn US$
Lithuania	2015	2.80 M	65,000 km^2	66.45 bn US$
Luxembourg	1999	0.64 M	2,590 km^2	85.51 bn US$
Malta	2008	0.52 M	320 km^2	17.36 bn US$
Netherlands	1999	17.53 M	42,000 km^2	1.013 tn US$
Portugal	1999	10.33 M	92,000 km^2	253.66 bn US$
Slovakia	2009	5.45 M	49,000 km^2	116.53 bn US$
Slovenia	2007	2.11 M	21,000 km^2	61.75 bn US$
Spain	1999	47.42 M	506,000 km^2	1.427 tn US$

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Dependent territories: Some of the above-mentioned member states have other external territories dependent on them. These are not independent states, but they do have some economic and political autonomy. The EMU treaties apply to them at least in part. These countries are not listed as official member states.

Country	Region	Dependency
Åland	Northern Europe	Territory of Finland
Aruba	Caribbean	Territory of the Netherlands Kingdom
Caribbean Netherlands	Caribbean	Territory of the Netherlands
French Antarctic Lands	Antarctica	Territory of France
French Guiana	South America	Territory of France
French Polynesia	Polynesia	Territory of France
Guadeloupe	Caribbean	Territory of France
Martinique	Caribbean	Territory of France
Mayotte	Eastern Africa	Territory of France
New Caledonia	Melanesia	Territory of France
Reunion	Eastern Africa	Territory of France
Saint Barthelemy	Caribbean	Territory of France
Saint Martin	Caribbean	Autonomous territory of the Netherlands Kingdom
Saint Pierre and Miquelon	North America	Territory of France
St. Martin	Caribbean	Territory of France
Wallis and Futuna	Polynesia	Territory of France

9.2. HISTORY OF ECONOMIC AND MONETARY UNION (EMU)

Economic and monetary union (EMU) is the result of progressive economic integration in the European Union (EU). It is an expansion of the EU single market, with common product regulations and free movement of goods, capital, labour and services. A common currency, the euro, has been introduced in the euro area, which currently comprises 19 EU Member States. All EU Member States – with the exception of Denmark – must adopt the euro once they fulfill the convergence criteria. A single monetary policy is set by the Euro system (comprising the European Central Bank's Executive Board and the governors of the central banks of the euro area) and is complemented by fiscal rules and various degrees of economic policy coordination. Within EMU there is no central economic government. Instead, responsibility is divided between Member States and various EU institutions.

History of EMU: At the summit in The Hague in 1969, the Heads of State or Government defined a new objective of European integration: economic and monetary union (EMU). A group headed by Pierre Werner, Prime Minister of Luxembourg, drafted a report outlining the achievement of full economic and monetary union within 10 years according to a plan to be carried out in several stages. The ultimate goal was to achieve full liberalisation of capital movements, the total convertibility of Member States' currencies, and the irrevocable fixing of exchange rates. The collapse of the Bretton Woods system and the decision of the US Government to float the dollar in 1971 produced a wave of instability in respect of foreign exchange, which called into serious question the parities between the European currencies. The EMU project was brought to an abrupt halt.

At the 1972 Paris Summit, the EU attempted to impart fresh momentum to monetary integration by creating the 'snake in the tunnel': a mechanism for the managed floating of currencies (the 'snake') within narrow margins of fluctuation against the dollar (the 'tunnel'). Thrown off course by the oil crises, the weakness of the dollar and differences in economic policy, the 'snake' lost most of its members in less than two years and was finally reduced to a 'mark area' comprising Germany, the Benelux countries and Denmark. Efforts to establish an area of monetary stability were renewed at the Brussels Summit in 1978 with the creation of the European Monetary System (EMS), based on the concept of fixed but adjustable exchange rates. The currencies of all Member States, except the UK (when it was still part of the EU), participated in the exchange rate mechanism, ERM I. Exchange rates were based on central rates against the ECU (European Currency Unit), the European unit of account, which was a weighted average of the participating currencies. A grid of bilateral rates was calculated on the basis of these central rates expressed in ECU, and currency fluctuations had to be contained within a margin of 2.25% either side of the bilateral rates (with the exception of the Italian lira, which was allowed a margin of 6%). Over a 10-year period, the EMS did much to reduce exchange rate variability: the flexibility of the system, combined with the political resolve to bring about economic convergence, achieved currency stability. However, as a result of speculative attacks against several currencies in 1993, the fluctuation margins were expanded to 15%. With the adoption of the Single Market Programme in 1985, it became increasingly clear that the potential of the internal market could not be fully achieved as long as relatively high transaction costs linked to currency conversion and the uncertainties linked to exchange rate fluctuations, however small, persisted. In addition, many economists denounced what they called the 'impossible triangle': free movement of capital, exchange rate stability and independent monetary policies, which were deemed incompatible in the long term.

In 1988, the Hanover European Council set up a committee to study EMU under the chairmanship of Jacques Delors, the then Commission President. The committee's report (the Delors report), submitted in 1989, proposed strengthening a three-stage introduction of EMU. In particular, it stressed the need for better coordination of economic policies, the establishment of fiscal rules that set limits for deficits in national budgets, and the creation of an independent institution that would be responsible for the Union's monetary policy: the European Central Bank (ECB). On the basis of the Delors report, the Madrid European Council decided in 1989 to launch the first stage of EMU: the full liberalisation of capital movements by 1 July 1990.

In December 1989, the Strasbourg European Council called for an intergovernmental conference to identify what amendments to the Treaty were needed in order to achieve EMU. The work of this intergovernmental conference led to the Treaty on European Union, which was formally adopted by the Heads of State or Government at the Maastricht European Council in December 1991 and came into force on 1 November 1993.

The Treaty provided for EMU to be introduced in three stages (some key dates of which were left open and would be set at later European summits as events progressed):

Stage 1 (from 1 July 1990 to 31 December 1993): establishing the free movement of capital between Member States;

Stage 2 (from 1 January 1994 to 31 December 1998): convergence of Member States' economic policies and strengthening of cooperation between Member States' national central banks. The coordination of monetary policies was institutionalised by the establishment of the European Monetary Institute (EMI), which was tasked with strengthening cooperation between the national central banks and with carrying out the necessary preparations for the

introduction of the single currency. The national central banks were to become independent during this stage;
Stage 3 (which started on 1 January 1999): implementation of a common monetary policy under the aegis of the Eurosystem from the very first day and the gradual introduction of the euro notes and coins in all euro area Member States. Transition to the third stage was subject to the achievement of a high degree of durable convergence measured against a number of criteria laid down by the Treaties. The budgetary rules were to become binding and any Member State failing to comply could face penalties. The monetary policy for the euro area was entrusted to the Eurosystem, made up of the six members of the ECB's Executive Board and the governors of the national central banks of the euro area.

In principle, by adhering to the Treaties, all EU Member States agreed to adopt the euro (Article 3 of the TEU and Article 119 of the TFEU). However, no deadline has been set and some Member States have not yet fulfilled all the convergence criteria. These Member States benefit from a provisional derogation. Furthermore, the United Kingdom and Denmark had given notification of their intention not to participate in the third stage of EMU and therefore not to adopt the euro. Since the United Kingdom left the EU in 2020, only Denmark currently benefits from an exemption with regard to its participation in EMU's third stage, but maintains an option to end its exemption. The exemption arrangements are detailed in a protocol annexed to the EU Treaties. At the time of writing, 19 of the 27 Member States have adopted the euro.

In the aftermath of the European sovereign debt crisis, which unfolded in 2009-2010, EU leaders pledged to strengthen EMU, including by improving its governance framework. A Treaty amendment, affecting Article 136 of the TFEU, allowed for the creation of a permanent support mechanism for Member States in distress, provided the mechanism is based on an intergovernmental treaty, the stability of the euro area as a whole is threatened and the financial support is linked to strict conditionality. This led to the establishment of the European Stability Mechanism (ESM) in October 2012, which replaced several ad hoc mechanisms. In addition, ECB President Mario Draghi announced in 2012 that 'within our mandate, the ECB is ready to do whatever it takes to preserve the euro'. To this end, it created the Outright Monetary Transactions (OMT) instrument. The OMT allows ECB to buy the sovereign bonds of a Member State in distress, provided the country signs a memorandum of understanding with the ESM, thus indirectly making ECB support subject to strict conditionality. To avoid a reoccurrence of a sovereign debt crisis, EMU's secondary legislation was upgraded. The European Semester was established, which strengthened the Stability and Growth Pact (SGP), introduced the Macroeconomic Imbalance Procedure (MIP), and endeavoured to further strengthen economic policy coordination. The improved economic governance framework was supplemented with intergovernmental treaties, such as the Treaty on Stability, Coordination and Governance (TSCG or 'Fiscal Compact') and the Europlus Pact.

A first attempt to further elevate EMU was proposed by the Commission in its Blueprint for a deep and genuine EMU in 2012. The ultimate aim would have been the establishment of a political union. Another 2012 initiative, the less ambitious 'Four Presidents' Report', failed to initiate substantial changes to EMU's economic governance framework. In 2015, taking inspiration from the Blueprint, the Presidents of the European Commission, the European Council, the Eurogroup, the ECB and the European Parliament published a report on Completing Europe's Economic and Monetary Union ('Five Presidents' Report'). It outlined a reform plan aimed at achieving a genuine economic, financial, fiscal and political Union in three stages (to be completed by 2025 at the latest). However, in order to fully realise the grand plans of the Blueprint or the ‘Five Presidents’ Report’, it would be necessary to amend the EU Treaties in a substantial way. As no Treaty changes have been made since then, the most ambitious projects could not be realised.

The economic crisis induced by COVID-19 has put considerable pressure on public finances. In March 2020, the Council activated the SGP’s general escape clause to give Member States a limited time span in which they can increase their public debt beyond the constraints of fiscal rules. That same month, the ECB initiated the pandemic emergency purchase programme (PEPP), which includes the acquisition of large amounts of sovereign debt on the secondary markets. This provides liquidity to the markets and is designed to avoid the emergence of large spreads between German Bunds and government bonds from a number of highly indebted EU Member States. The amounts provided are very large, but the programme is limited in time. A strategy review was conducted by the ECB in the summer of 2021, the first since 2003, aiming for a 2% inflation target over the medium term, allowing for the target to be overshot on a temporary basis and for climate change to be taken into account in the Eurosystem’s decisions.

In 2022, the post-pandemic economic situation, as well as the fall-out from the war in Ukraine, mainly in form of steep energy price hikes, led to a historic increase in inflation in the euro area. The Eurosystem made a U-turn on its monetary policy, tapering asset purchases and increasing interest rates. Responding to fears that there would be excessive spreads for sovereign bonds of high-debt countries, the ECB announced an ‘anti-fragmentation tool’, the Transmission Protection Instrument (TPI), in July 2022. A debate in the Eurosystem and among euro area Member States on possible changes to the SGP gained momentum in the summer of 2022. However, Member States’ positions diverged so widely that there were doubts about the feasibility of any substantial changes. Yet a consensus emerged to allow high-debt countries more time to bring down their debt-to-GDP ratio.

Legal basis: Article 3 of the Treaty on European Union (TEU); Articles 3, 5, 119-144, 219 and 282-284 of the Treaty on the Functioning of the European Union (TFEU); Protocols annexed to the Treaties: Protocol 4 on the statute of the European System of Central Banks and the European Central Bank; Protocol 12 on the excessive deficit procedure; Protocol 13 on the convergence criteria; Protocol 14 on the Eurogroup; Protocol 16, which contains the opt-out clause for Denmark; Intergovernmental treaties comprise the Treaty on Stability, Coordination and Governance (TSCG), the Europlus Pact and the Treaty on the European Stability Mechanism (ESM).

Objectives: EMU is the result of step-by-step economic integration, and is therefore not an end in itself. EMU is designed to support sustainable economic growth and a high level of employment through appropriate economic and monetary policymaking. This comprises three main fields: (i) implementing a monetary policy that pursues the main objective of price stability; (ii) avoiding possible negative spillover effects due to unsustainable government finance, preventing the emergence of macroeconomic imbalances within Member States, and coordinating to a certain degree the economic policies of the Member States; (iii) ensuring the smooth operation of the single market.

Achievements: The euro is now part of daily life in 19 Member States of the European Union. Other Member States are expected to adopt it in the future. The single currency has a number of advantages, which include lowering the costs of financial transactions, making travel easier, and strengthening the role of Europe at international level. It helps complete the single market.

9.3 ROLE OF THE EUROPEAN PARLIAMENT

Since the entry into force of the Lisbon Treaty, the European Parliament has participated as co-legislator in establishing most of the detailed rules shaping the economic governance framework (based among others on Article 121, 126 and 136 of the TFEU). However, on some dossiers the Treaty only provides for a consultative role for Parliament, including, inter alia, the preventive part of the Stability and Growth Pact, as well as macroeconomic surveillance. In addition,

Parliament is consulted on the following issues: Agreements on exchange rates between the euro and non-EU currencies; Countries eligible to join the single currency; The appointment of the President, Vice-President and the four other members of the ECB
Executive Board; Some part of the legislation implementing the excessive deficit procedure. Each year, the ECB presents its annual report, which the ECB President then presents in plenary. Parliament usually reacts to the report by adopting an own-initiative report. Parliament has no decision-making powers for the different stages of the European Semester, but is regularly updated by the Commission and the Council, who hold the executive powers. Parliament’s role in the economic governance of the EU was somewhat strengthened by the European Semester, in particular through the setting-up of an ‘Economic Dialogue’ involving Parliament, the relevant Council formations and the Commission. Parliament may accompany the Semester by adopting own-initiative reports. By nature, Parliament is not formally involved in the establishment of intergovernmental treaties (e.g. the TSCG), or in the setting-up and running of intergovernmental mechanisms (e.g. the ESM), although Parliament establishes a variety of contacts and is involved in exchanges of views nevertheless**.**

9.4. EUROPEAN PARLIAMENT- OVERVIEW2

Role: Directly-elected EU body with legislative, supervisory, and budgetary responsibilities. **Members:** 705 MEPs (Members of the European Parliament). **President:** Roberta Metsola. **Established in:** 1952 as Common Assembly of the European Coal and Steel Community, 1962 as European Parliament, first direct elections in 1979. **Location:** Strasbourg (France), Brussels (Belgium), Luxembourg. **Website:** European Parliament. The European Parliament is the EU's law-making body. It is directly elected by EU voters every 5 years. The last elections were in May 2019. **Elections:** The European elections took place between 23-26 May 2019.- More about the 2019 European elections results.
What does the Parliament do? The Parliament has 3 main roles: Legislative: Passing EU laws, together with the Council of the EU, based on European Commission proposals- Deciding on international agreements- Deciding on enlargements- Reviewing the Commission's work programme and asking it to propose legislation.
Supervisory: Democratic scrutiny of all EU institutions- Electing the Commission President and approving the Commission as a body. Possibility of voting a motion of censure, obliging the Commission to resign- Granting discharge, i.e. approving the way EU budgets have been spent. Examining citizens' petitions and setting up inquiries- Discussing monetary policy with the European Central Bank- Questioning Commission and Council- Election observations. **Budgetary:** Establishing the EU budget, together with the Council- Approving the EU's long-term budget, the "Multiannual Financial Framework".
Composition: The number of MEPs for each country is roughly proportionate to its population, but this is by degressive proportionality: no country can have fewer than 6 or more than 96 MEPs and the total number cannot exceed 705 (704 plus the President). MEPs

are grouped by political affiliation, not by nationality. The President represents Parliament to other EU institutions and the outside world and gives the final go-ahead to the EU budget.

How does the Parliament work? Parliament's work comprises two main stages: Committees - to prepare legislation. The Parliament numbers 20 committees and three subcommittees, each handling a particular policy area. The committees examine proposals for legislation, and MEPs and political groups can put forward amendments or propose to reject a bill. These issues are also debated within the political groups. Plenary sessions – to pass legislation. This is when all the MEPs gather in the chamber to give a final vote on the proposed legislation and the proposed amendments. Normally held in Strasbourg for four days a month, but sometimes there are additional sessions in Brussels.

The Parliament and you: If you want to ask the Parliament to act on a certain issue, you can petition it (either by post or online). Petitions can cover any subject which comes under the EU's remit. To submit a petition, you must be a citizen of an EU member state or be resident in the EU. Companies or other organisations must be based here. Other ways of getting in touch with Parliament include contacting your local MEP or the European Parliament Information Office in your country.

Access to information-Transparency: Transparency is one of the EU's key principles. It requires the EU to disclose information on policy-making and spending and to uphold the principle of freedom of information. These principles are set out in the EU treaties. Article 10 of the Treaty on European Union stipulates that open decision-making is carried out 'as closely as possible to the citizen'. Article 11 states that both individuals and representative associations should be given the opportunity to 'make known and publicly exchange their views in all areas of Union action'. The Treaty on the Functioning of the European Union expands on these points. It states that the EU institutions are obliged to act publicly and to ensure that individuals and any natural or legal person residing or having its registered office in an EU country can access documents (Article 15). In practical terms, this means that you are entitled to access documents by the EU institutions, bodies and agencies, including legislative texts, official documents, meeting minutes and agendas. Follow the links on this page to access their databases and public registers, where you can obtain documents either directly online or upon request.

Access to documents: To increase transparency, the European Commission, European Parliament, European Council and Council of the EU publish their meeting schedules in advance and share information about their outcomes in press conferences. You can also follow Parliament sessions and parts of Council meetings online. All programming priorities, including the Commission's political guidelines, the State of the Union address and the Commission work programme, are made public. The European Council's strategic agenda and subsequent Council presidency priorities are also made public. You can consult the schedules of Commissioners, the European Council President and the European Parliament President. The remaining EU institutions and bodies also publish their presidents' schedules, calendars of meetings and web-streamed meetings. For more information, consult institutions and bodies.

EU databases-EUR-Lex: EUR-Lex is your gateway to EU law. You can search for treaties, legal acts, international agreements, law-making procedures, summaries of EU legislation and case law.

Transparency register: Search for organisations or register your own. The register includes information on interests being pursued, by whom and with what budgets at EU level. It is run by both the European Parliament and the European Commission. Note that organisation representatives cannot have high-level meetings with Commissioners or senior Commission officials if their organisation is not registered.

DORIE: Search the DORIE database for documents on EU issues from 1946 to the present day. These include legal instruments adopted by the EU institutions, minutes of meetings held by institutions and bodies, press releases, newspaper articles, speeches by European leaders and internal Commission notes.
EU publications": General report on the activities of the European Union: This report gives an account of the EU's major initiatives and achievements of the past year.
EU Publications Office: Search the online library of publications from the EU institutions and other bodies.
EU Open Data Portal: Search the EU Open Data Portal, a single entry point to data from the EU institutions and other bodies. You can use and re-use this data for commercial or non-commercial purposes.
Public registers: European Parliament-Public register of documents: Access documents produced or received by the European Parliament since December 2001. Includes meeting minutes, agendas, legislative texts and resolutions.
European Council-Document register: Access documents issued by the European Council since 1999. Includes conclusions (from 2004), meeting minutes, agendas, votes and outcomes.
Council of the EU-Document register: Access documents issued by the Council since 1999. Includes preparatory legislative documents, meeting minutes, agendas, votes and outcomes. Register of legislative acts under 'codecision' (ordinary legislative procedure). Search for EU legislative acts adopted under the ordinary legislative procedure. Includes both ongoing and completed procedures.
European Commission- Register of Commission documents: Access documents produced or received by the Commission since January 2001. Includes legislative documents together with minutes and agendas of meetings.
Comitology register: Search for information and documents relating to the work of committees that help the Commission implement EU legislation.
Court of Justice of the European Union:-Access to administrative documents: Request access to administrative documents held by the Court of Justice of the EU.
European Central Bank (ECB): Public register of documents- Access documents released by the ECB. Includes diaries, decisions, opinions, agendas and meeting minutes.
European Court of Auditors (ECA): Access to documents- Apply for access to documents issued by the ECA in writing or by email.
European External Action Service (EEAS): EEAS public register- Access documents produced by the EEAS since January 2015. Includes proposals, recommendations, working documents and administrative decisions.
European Economic and Social Committee (EESC): EESC public documents- Access documents produced by the EESC. They are available in electronic format.
European Committee of the Regions (CoR): Access to documents- Contact the Transparency and Access to Documents Department to request access to documents produced by the CoR.
European Investment Bank (EIB): Public register- Access environmental and social information/documents on sustainable investment projects, as well as environmental policy documents.
European Ombudsman: Public register- Search for core business documents (cases, decisions, recommendations) and documents relating to strategy, policy and high-level management.

European Data Protection Supervisor (EDPS): Records register- Access the records of EDPS activities on processing personal data.
European Data Protection Board (EDPB): Public registers* Access the EDPB's three public registers. Includes records on codes of conduct, certification mechanisms, seals and marks, and binding corporate rules.
EU information centers: Europe Direct Information Centres- Contact your local Europe Direct Information Centre to find out more about how the EU works.

9.5. BANK OF ENGLAND (BOE)-CENTRAL BANK OF THE UK

The Bank of England (BoE) is the central bank of the United Kingdom and a model on which most central banks around the world are built. Since its inception in 1694, the bank has changed from being a private bank that loaned money to the government, to being the official central bank of the United Kingdom. The bank started during a period of economic turbulence when the national debt was growing at a steady rate. The Bank of England became the official central bank of the UK in 1946. It is owned by the Treasury Solicitor, on behalf of the government. Previously, it was the property of stockholders from its foundation. The bank's central offices are in London's financial district, along Threadneedle Street. It is from this street that the bank got the name "Old Lady of the Threadneedle Street," a name derived from the legendary Sarah Whitehead, who previously lived at the current location of the bank's headquarters.

Bank of England (BoE)- The Governance of the Bank of England:
The Court of Directors oversees the operations of the bank and the court members are appointed by the Queen, but on the recommendation of the Chancellor and the Prime Minister. The court has five executive members and nine non-executive members. One of the non-executive members is appointed by the Chancellor of the Exchequer to chair the court. It sets and monitors the bank's strategy, as well as making important decisions on resource utilization. Also, there are several subcommittees, each tasked with handling specific responsibilities of the bank.
The most senior position at the bank is that of the Governor. Unlike the Court of Directors, the appointment for the post of the Governor comes from within the bank, with the incumbent Governor grooming their successor. The most recent occupant of the position was Mark Carney, a Canadian and the first non-British person to hold the governor's position. The newly named governor is Andrew Bailey, who took over the position in March 2020.

History of the Bank of England: The Bank of England started in 1694, following a crushing defeat of English forces by the French and spurred by the need to establish England as a global power. The government's coffers were depleting at a fast rate during the war and they had to find new avenues to borrow money and finance the growing national debt. At its inception, the bank was a private institution with the power to raise funds through the issuance of bonds.
Following the enactment of the Bank Charter Act in 1844, the bank got monopoly power on the issuing of bank notes in England and Wales, a significant step toward becoming the official government banker. The bank had the sole right to issue bank notes, except for a few smaller banks that had already been granted such rights and that were required to be headquartered outside London.
After the 1997 general election, the Chancellor of the Exchequer announced that the Bank of England would be granted independence over monetary policy. The announcement gave the bank independence in setting interest rates. The bank's Monetary Policy Committee is

responsible for setting the interest rate to meet the Consumer Price Index (CPI) inflation target of 2%. In a scenario where inflation increases or decreases by 1% beyond the target inflation rate, the Governor is required to write a letter to the Chancellor of the Exchequer explaining the situation and offering potential solutions.

Functions of the BoE: The Bank of England's primary functions are to maintain monetary stability and oversee financial stability of the UK financial system. The bank also acts as the lender of last resort and as the custodian of the official gold reserves in the United Kingdom.

Monetary Stability: Monetary stability relates to maintaining stable prices and confidence in the currency. The BoE has been tasked with the responsibility to issue bank notes in the United Kingdom for over 300 years now. Also, as the central bank of the UK, the Bank of England is responsible for maintaining confidence that the currency in circulation is genuine. The bank has delegated the role of formulating monetary policy to the Monetary Policy Committee (MPC), a nine-member committee led by the Governor. Other members include three deputy governors, the BoE's chief economist, and four members appointed by the Chancellor of the Exchequer. The MPC meets regularly to discuss the need to alter the interest rate policy to achieve the inflation target. It also monitors developments in the economy.

Financial Stability: Financial stability involves monitoring the financial system so that there is confidence in the financial institutions, markets, and the overall financial system. It also entails protecting the financial system against threats by detecting them through surveillance and market intelligence functions, as well as finding solutions when problems arise. Threats to the financial system include bribery, corruption, counterfeiting, and money laundering. The Financial Services Act of 2012 established two institutions to deal with financial stability, i.e., the Financial Policy Committee (FPC) and the Prudent Regulation Authority (PRA). The role of the FPC is to identify, monitor, and take action against risks that threaten the resilience of the UK financial system. The PRA regulates commercial banks, building societies, credit unions, insurers, and investment firms in the UK.

Official Gold Reserves Custodian: The Bank of England acts as the official gold reserves custodian for the UK and other countries. It is estimated that the bank holds approximately 3% of all the gold mined in the history of the world. As of April 2014, the bank had nearly 400,000 gold bullion bars, valued at £142 billion.

Lender of Last Resort: As the central bank of the UK, the Bank of England acts as a lender of last resort for commercial banks that suffer a cash shortfall. This role helps maintain liquidity and confidence in the financial system. In a famous example, when Northern Rock Bank in the UK suffered severe financial hardships, it had to borrow funds from the BoE.

9.6. SUMMARY

After studying this lesson student should be able to Know about the European Monetary Union-Understand for History of Economic and monetary union (EMU)- Explain the Role of the European Parliament- Awareness regarding The Bank of England (BoE). A monetary union was established in 1999 and came into full force in 2002 and is composed of 19 EU member states which use the euro currency. The common goal of the union is the further development and stabilization of the European internal market. The basic prerequisite for admission to EMU is membership in the European Union. Even financially strong and stable

countries outside the EU cannot become Alliance members. A common currency, the euro, has been introduced in the euro area, which currently comprises 19 EU Member States. At the summit in The Hague in 1969, the Heads of State or Government defined a new objective of European integration: economic and monetary union (EMU). EMU is the result of step-by-step economic integration, and is therefore not an end in itself. EMU is designed to support sustainable economic growth and a high level of employment through appropriate economic and monetary policymaking. Transparency is one of the EU's key principles. It requires the EU to disclose information on policy-making and spending and to uphold the principle of freedom of information. These principles are set out in the EU treaties. The Bank of England (BoE) is the central bank of the United Kingdom and a model on which most central banks around the world are built. Since its inception in 1694, the bank has changed from being a private bank that loaned money to the government, to being the official central bank of the United Kingdom.

9.7. TECHNICAL TERMS

European Monetary Union: The European Economic and Monetary Union (EMU)combines several of the European Union (EU) member states into a cohesive economic system. It is the successor to the European Monetary System (EMS).

Economic&Monetary union: An economic and monetary union (EMU) is a type of trade block that features a combination of a common market customs union, and monetary union. Established via a trade pact, an EMU constitutes the sixth of seven stages in the process of economic integration.

European internal market: The European single market, internal market or commonmarket is a single market comprising the 27 member states of the European Union (EU) as well as – with certain exceptions – Iceland, Liechtenstein, and Norway through the Agreement on the European Economic Area, and Switzerland through sectoral treaties.

The Bank of England (BoE): The Bank of England is the central bank of the United Kingdom and the model on which most modern central banks have been based. Established in 1694 to act as the English Government's banker, and still one of the bankers for the Government of the United Kingdom, it is the world's eighth-oldest bank.

9.8. SELF ASSESSMENT QUESTIONS

1. Discuss about the history of European Monetary Union.
2. Explain briefly about Economic and monetary union.
3. What is the role of The Bank of England (BoE) as a central bank of UK.
4. Explain the Role of the European Parliament **.**

9.9. SUGGESTED READINGS

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11. Written by CFI Team- Updated December 27, 2022

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LESSON-10
EUROPEAN CENTRAL BANK (ECB)

AIMS AND OBJECTIVES

After studying this lesson student should be able to

- Know about the History of European Central Bank
- Explain for Objectives, Functions of the European Central Bank
- Understand Organization structure of European Central Bank (ECB)

STRUCTURE

10.1. INTRODUCTION: HISTORY OF THE EUROPEAN CENTRAL BANK

The ECB first exercised its full powers on 1 January 1991 after the introduction of the Euro as the official currency for the Euro area. During this time, the national central banks of the 11 EU member states transferred their monetary policy function to the ECB. The ECB was created in June 1998, following the Treaty of Amsterdam that amended the Treaty on the European Union. The bank succeeded the European Monetary Institute (EMI) which had been formed at the second stage of the Economic and Monetary Union (EMU) to handle transitional issues of adopting the Euro as the common currency of the European Union. It also prepared for the creation of the European System of Central Banks (ESCB). The ESCB includes the ECB and the national central banks of all the EU member states, including those that have not adopted the Euro. The European Central Bank was started on January 1, 1999, when some European Union members adopted the Euro currency. It is a bank for Europe's single currency, i.e., the Euro, which aims to maintain the price stability of the Euro in the international market. The head office is situated in Germany and consists of 27 members currently. The main aim behind establishing the Bank is to increase the purchasing power through various monetary policies. It also guides the members about implementing various policies and other financial matters. In addition, the bank is accountable to the public through the parliament and publishes the annual report of its accounts, functions, and actions. Other states within the EU joined later on, with Greece, Slovenia, Cyprus, Malta, Slovakia, Estonia, Latvia, and Lithuania joining the EU between 2001 to 2015. The expansion enlarged the bank's scope and marked a milestone in the complex process of EU integration.

The first President of the ECB was Win Duisenberg, who was also the former president of the EMI and the Dutch central bank. His proponents saw him as a guarantor of a strong Euro, and he had the support of the German, Dutch, and Belgian governments. The French government had opposed Duisenberg taking over the presidency of the ECB, instead opting to have a French citizen as the president. They resolved the disagreement through a gentleman's agreement where Duisenberg agreed to step down prior to the end of his term, for Trichet, a French national, to take over.

10.2. DEFINITION OF EUROPEAN CENTRAL BANK (ECB)

The European Central Bank is the apex bank of the European member countries which monitors the banking and financial functions of all the member countries to maintain the price stability of the European currency, i.e., Euro which is adopted by all the member countries to maintain the price stability and prevent themselves from financial troubles.

The European Central Bank (ECB) is the central bank responsible for monetary policy of the European Union (EU) member countries that have adopted the euro currency. This currency union is known as the eurozone and currently includes 19 countries. The ECB's primary objective is price stability in the euro area. The European Central Bank (ECB) is one of the seven institutions of the EU and the central bank for the entire Eurozone. It is one of the most critically important central banks in the world, supervising over 120 central and commercial banks in the member states. The ECB works with the central banks in each EU state to formulate monetary policy to help maintain stable prices and strengthen the Euro.

The European Central Bank (ECB) is the central bank of the European Union and the Euro zone currency union.The ECB coordinates Eurozone monetary policy, including setting target interest rates and controlling the supply of the euro common currency.The ECB's primary mandate is price stability; it targets 2% inflation over the medium term as a buffer against the risk of destabilizing deflation. ECB decisions on monetary policy and banking supervision are made by the ECB Governing Council comprising six executive board members and a monthly rotation of national central bank governors. Understanding European Central Bank (ECB). The European Central Bank (ECB) is headquartered in Frankfurt am Main, Germany. It has been responsible for monetary policy in the Euro area since 1999, when the euro currency was first adopted by some EU members.

10.3. OBJECTIVES OF EUROPEAN CENTRAL BANK

The European Central Bank is the central bank of the European countries, which has the single aim of maintaining the price stability of the Euro, which is adopted by all the member states. It aims to control inflation by monitoring the monetary policy and controlling the money supply in the market through interest rates. It is managed and monitored by the team of the European central bank. The team members are amongst representatives of the member states as decided and agreed mutually. The bank functions according to the predefined rules and regulations, and all the decisions are taken on the majority basis after surveying the market situations and conditions.

1. Maintain the price stability of the currency, i.e., Euro.
2. To monitor the banking system of member states.
3. To monitor and aid in preparing the monetary policy.
4. Ensure the economic growth and maintenance of purchasing power.
5. Guiding the member states about the foreign exchange operations and the transactions.
6. Ensures the smooth conduct of business and economy.
7. Maintains the balance of trade in terms of imports and exports.
8. Issue the guidelines on operations by the member states' banks also ensure compliances.

10.4. FUNCTIONS OF EUROPEAN CENTRAL BANK (ECB)

The primary function of the European Central Bank is to maintain price stability and safeguard the value of the Euro. The Governing Council defined price stability as inflation of under but close to 2%. Price stability is essential for spurring economic growth and job creation, which are core objectives of the EU. One of the primary functions of this body is the formulation of monetary policy for the Euro area. In this regard, they make decisions on monetary objectives, interest rates, and the supply of reserves in the Eurosystem. Every six weeks, the President and Vice-President of the ECB must chair a press conference to explain in detail their monetary policy decisions.

Functions of ECB

1. To Prepare the Monetary policies to maintain the price stability.
2. Monitor the banking and financial institutions and ensures their compliance with the regulation and smooth conduct.
3. To control the inflation and unemployment of the member states.
4. Monitor the import-export transactions of the member states.
5. Guides the member states on the functioning.
6. Conduct surveys and audits of the member states.
7. Maintain the stability of the currency in the international market.
8. They are ensuring the economy's smooth functioning.
9. Formulate plans for economic growth.
10. Ensures transparency and accountability at all levels and professional competency of all the members.

10.5. ROLES & RESPONSIBILITIES OF EUROPEAN CENTRAL BANK (ECB)

The ECB has a monopoly on the issuing of banknotes in the Euro area. It influences the amount of money in the market by controlling money available to eligible central and commercial banks in EU member states. Also, the ECB makes weekly announcements on the amount of money it wishes to supply and the minimum acceptable interest rate. Eligible banks that have provided collateral then place their bids for the ECB funds through an auction mechanism. Once the banks have obtained funds, they use them to advance loans to individuals and businesses.

To ensure the robustness of the banking system, the ECB is responsible for banking supervision in all the EU member states. The European Central Bank carries out this function through the Single Supervisory Mechanism (SSM) that comprises the ECB and competent national authorities in the member countries. In respect to banking supervision, the ECB has the power to grant and withdraw banking licenses, conduct supervisory reviews, and set

higher capital requirements to counter financial risks. The ECB directly supervises 124 significant banks that hold 82% of the banking assets in the Euro area.
Other responsibilities of the European Central Bank include conducting foreign exchange operations, promoting the proper functioning and safety of payment systems, and managing the Eurozone’s foreign currency reserves.

The primary responsibility of the ECB, linked to its mandate of price stability, is formulating monetary policy. Monetary policy decision meetings are held every six weeks, and the ECB is transparent about the reasoning behind the resulting policy announcements. It holds a press conference after each monetary policy meeting, and later publishes the meeting minutes. The Eurosystem comprises the ECB and the central banks of Eurozone countries. The Eurosystem manages the euro currency and supports the ECB's monetary policy. The parallel European System of Central Banks includes all central banks of EU states, including those that have not adopted he euro.

The ECB is also the EU body responsible for banking supervision. In conjunction with national central bank supervisors, it operates what is called the Single Supervisory Mechanism (SSM) to ensure the soundness of the European banking system. The SSM enforces the consistency of banking supervision practices for member countries—lax supervision in some member countries contributed to the European financial crisis. The SSM was launched in 2014. All euro area countries are in the SSM and non-euro EU countries can choose to join.

10.6. ORGANIZATION STRUCTURE OF THE EUROPEAN CENTRAL BANK

President and vice-president are the chairpersons of the bank, which ensures, monitors, and issues the various guidelines.The Governing Council consists of members under the president and vice-president and six persons as members of the executive board and the governors of the member states. The governing council participates in policy formulation and strategic decisions.Under the Governing council, there is an executive board that consists of a president, vice-president, and the four members nominated by the executive council. They are responsible for monitoring and enforcing the guidelines and policies. After the Governing council, there is a general council consisting of the president, vice-president, and the governors of the member states responsible for data collection and implementation of their state and report on the implementation of the guidelines and policies. Under the general council, a supervisory **board** consist of the members nominated by the European Central bank, which supervises the banking and financial activities at the ground level. At all levels, transparency and accountability are the musts.

European Central Bank (ECB)- Central bank for the entire Eurozone

There are four decision-making bodies of the ECB that are mandated to undertake the objectives of the institution. These bodies include the Governing Council, Executive Board, the General Council, and the Supervisory Board.The ECB's mandate is for price stability and it targets an annual inflation rate of 2% over the medium term. Like the Federal Reserve's inflation targeting, it is symmetrical, so that inflation too low relative to its target is viewed as negatively as inflation above it. The 2% target provides a buffer against the risk of a destabilizing deflation during a recession.

The Governing Council: The Governing Council comprises six members of the Executive Board and Governors of the national central banks of the Euro area member states. The Council members meet twice a month at the institution's offices in Germany. The minutes of their meetings are required to be published prior to the next meeting. The Governing Council also makes necessary decisions that ensure the performance of the functions of ECB and the Eurosystem. The ECB Governing Council makes decisions on eurozone monetary policy, including its objectives, key interest rates and the supply of reserves in the Eurosystem comprising the ECB and national central banks of the eurozone countries. It also sets the general framework for the ECB's role in banking supervision.

The Executive Board: The Executive Board comprises the President, Vice-President, and four other executive members appointed by the European Council. The executive members serve for an eight-year non-renewable term. The role of the Executive Board is to implement the monetary policy as defined by the Governing Council and manage the day-to-day operations of the ECB, alongside the Chief Services Officer. Also, the board prepares the Governing Council meetings and exercises power delegated to it by the Governing Council. It holds meetings every Tuesday.

The General Council: The General Council is a transitional body that carries out responsibilities taken over from the European Monetary Institute (EMI). It comprises the President, Vice-President, and Governors of the national central banks of the EU member states. The body will continue to exist until all EU member states have adopted the Euro. As of 2017, only 19 out of the 28 EU member states have taken up the Euro as their single currency. The Council consists of six executive board members and a rotation of 15 national central bank governors. Instead of an annual rotation of voting rights, as for regional Federal Reserve bank presidents, the ECB rotates voting rights monthly. Central bank governors from the top five countries by the size of their economies and banking systems—as of May 2022, Germany, France, Italy, Spain, and the Netherlands—share four voting rights, while the central banks of the other countries vote only slightly less frequently at 11 months out of every 14. As a transitional body, the General Council is tasked with fixing the exchange rates of currencies for countries taking up the Euro. The council also contributes to the preparation of the ECB annual report, setting conditions of employment for the European Central Bank members of staff, and collecting data.

The Supervisory Board: The Supervisory Board comprises the chair, vice-chair, four ECB representatives, and representatives of national supervisors. The board plans and executes the supervisory function of the ECB. It also proposes draft decisions for the Governing Council through the non-objection procedure.There is a Steering Committee that supports the board's activities, including organizing the board's meetings. The Steering Committee members comprise the Chair and Vice-Chair of the Supervisory Board, One ECB representative, and five representatives of national supervisors.

10.7. EUROPEAN INTEREST RATE

Prior to 10 March 2004, changes to the interest rate for main refinancing operations were, as a rule, effective as of the first operation following the date indicated, unless stated otherwise. The change on 18 September 2001 was effective on that same day. From 10 March 2004 onwards, the date refers both to the deposit and marginal lending facilities and to the main refinancing operations (with changes effective from the first main refinancing operation following the Governing Council decision), unless otherwise indicated. On 22 December 1998 the ECB announced that, as an exceptional measure between 4 and 21 January 1999, a narrown corridor of 50 basis points would be applied between the interest rates for the marginal lending facility and the deposit facility, aimed at facilitating the transition to the new regime by market participants. On 8 June 2000 the ECB announced that, starting from the operation to be settled on 28 June 2000, the main refinancing operations of the Eurosystem would be conducted as variable rate tenders. The minimum bid rate refers to the minimum interest rate at which counterparties may place their bids. As of 9 October 2008 the ECB reduced the standing facilities corridor from 200 basis points to 100 basis points around the interest rate on the main refinancing operations. On 8 October 2008 the ECB announced that, starting from the operation to be settled on 15 October, the weekly main refinancing operations would be carried out through a fixed-rate tender procedure with full allotment at the interest rate on the main refinancing operations. This change overrode the previous decision (made on the same day) to cut by 50 basis points the minimum bid rate on the main refinancing operations conducted as variable rate tenders.

The current European interest rate ECB (base rate) is 3.000 % European Central Bank The European Central Bank (ECB) is the central bank for the eurozone (euro area, the countries which have adopted the euro). One of the ECB's important tasks is to set and implement European monetary policy. This includes the use of the interest rate tool.

Key ECB interest rates: The Governing Council of the ECB sets the key interest rates for the euro area: The interest rate on the main refinancing operations (MRO), which provide the bulk of liquidity to the banking system. The rate on the deposit facility, which banks may use to make overnight deposits with the Eurosystem. The rate on the marginal lending facility, which offers overnight credit to banks from the Eurosystem.

The latest rate rise comes in spite of mounting fears that the currency area's economy will shrink in the coming months as surging energy prices — largely the result of Russia's throttling of critical European gas supplies — hit businesses and households throughout the region. The ECB raised rates by 50bp in July, its first such move for more than a decade. But its last 75bp increase was a three-week technical adjustment to smooth the euro's launch in 1999. German bonds sold off, with the yield on two-year debt, which is sensitive to changes in interest rate expectations, rising 0.28 percentage points to 1.37 per cent — its highest level in 11 years. The 10-year Bund yield, seen as a proxy for borrowing costs across the eurozone, rose 0.17 percentage points to 1.74 per cent. Italian bond prices also fell, with the 10-year yield climbing 0.22 percentage points to 4.09 per cent, according to Trade web data.

Date (with effect from)		Deposit facility	Main refinancing operations		Marginal lending facility
			Fixed rate tenders Fixed rate	Variable rate tenders Minimum bid rate	
2023	8 Feb.	2.50	3.00	-	3.25
2022	21 Dec.	2.00	2.50	-	2.75
2022	2 Nov.	1.50	2.00	-	2.25
2022	14 Sep.	0.75	1.25	-	1.50
2022	27 Jul.	0.00	0.50	-	0.75
2019	18 Sep.	−0.50	0.00	-	0.25
2016	16 Mar.	−0.40	0.00	-	0.25
2015	9 Dec.	−0.30	0.05	-	0.30
2014	10 Sep.	−0.20	0.05	-	0.30
	11 Jun.	−0.10	0.15	-	0.40
2013	13 Nov.	0.00	0.25	-	0.75
	8 May.	0.00	0.50	-	1.00
2012	11 Jul.	0.00	0.75	-	1.50
2011	14 Dec.	0.25	1.00	-	1.75
	9 Nov.	0.50	1.25	-	2.00
	13 Jul.	0.75	1.50	-	2.25
	13 Apr.	0.50	1.25	-	2.00
2009	13 May	0.25	1.00	-	1.75
	8 Apr.	0.25	1.25	-	2.25
	11	0.50	1.50	-	2.50

Date (with effect from)		Deposit facility	Main refinancing operations		Marginal lending facility
			Fixed rate tenders Fixed rate	Variable rate tenders Minimum bid rate	
	Mar.				
	21 Jan.	1.00	2.00	-	3.00
2008	10 Dec.	2.00	2.50	-	3.00
	12 Nov.	2.75	3.25	-	3.75
	15 Oct.[4]	3.25	3.75	-	4.25
	9 Oct.[3]	3.25	-	-	4.25
	8 Oct.	2.75	-	-	4.75
	9 Jul.	3.25	-	4.25	5.25
2007	13 Jun.	3.00	-	4.00	5.00
	14 Mar.	2.75	-	3.75	4.75
2006	13 Dec.	2.50	-	3.50	4.50
	11 Oct.	2.25	-	3.25	4.25
	9 Aug.	2.00	-	3.00	4.00
	15 Jun.	1.75	-	2.75	3.75
	8 Mar.	1.50	-	2.50	3.50
2005	6 Dec.	1.25	-	2.25	3.25
2003	6 Jun.	1.00	-	2.00	3.00
	7 Mar.	1.50	-	2.50	3.50
2002	6 Dec.	1.75	-	2.75	3.75

Date (with effect from)		Deposit facility	Main operations	refinancing	Marginal lending facility
			Fixed rate tenders Fixed rate	Variable rate tenders Minimum bid rate	
2001	9 Nov.	2.25	-	3.25	4.25
	18 Sep.	2.75	-	3.75	4.75
	31 Aug.	3.25	-	4.25	5.25
	11 May	3.50	-	4.50	5.50
2000	6 Oct.	3.75	-	4.75	5.75
	1 Sep.	3.50	-	4.50	5.50
	28 Jun.[2]	3.25	-	4.25	5.25
	9 Jun.	3.25	4.25	-	5.25
	28 Apr.	2.75	3.75	-	4.75
	17 Mar.	2.50	3.50	-	4.50
	4 Feb.	2.25	3.25	-	4.25
1999	5 Nov.	2.00	3.00	-	4.00
	9 Apr.	1.50	2.50	-	3.50
	22 Jan.	2.00	3.00	-	4.50
	4 Jan. [1]	2.75	3.00	-	3.25
	1 Jan.	2.00	3.00	-	4.50

10.8. ECB RAISES RATES BY 75 BASIS POINTS AND PROMISES MORE TO COME

Central bank increases eurozone borrowing costs to their highest level since 2011 The European Central Bank has raised interest rates 75 basis points to tackle record inflation, despite fears soaring energy prices will push the eurozone into recession. The decision, which was unanimously backed by all 25 members of the governing council and matches the ECB's previous biggest increase in borrowing costs, lifts the bank's benchmark deposit rate from zero to 0.75 per cent — the highest level since 2011.

Christine Lagarde, the ECB's president, said investors should not assume moves on this scale were "the norm", but there would be "several" rate rises in the coming months to bring inflation down from its latest "far too high" record of 9.1 per cent back towards the bank's target of 2 per cent. There were "probably more than two" increases to come including the latest one, "but also probably less than five", she told the media following the decision. The euro lost 0.4 per cent against the dollar in the late afternoon to trade at $0.996. Europe's regional Stoxx 600 share gauge closed the session 0.5 per cent higher, retracing declines earlier in the session.The ECB has lagged behind most major central banks in its response to high inflation. The US Federal Reserve is widely expected to announce a third consecutive 75bp rise at its meeting this month, which would lift the federal funds rate to a target range of 3 per cent to 3.25 per cent.

In response to the ECB move, Denmark's central bank also raised its benchmark rate 75bp to 0.65 per cent, in line with its mandate to keep the Danish crown stable against the euro. The move ended nearly a decade of negative policy rates in the country. So far eurozone economic data have remained surprisingly resilient. Growth rose by an unexpectedly strong 0.8 per cent in the second quarter and the unemployment rate hit a record low of 6.6 per cent in July, bolstering calls by hawkish ECB policymakers for more "forceful" action on rates. The Frankfurt-based bank lifted its growth forecast for this year to 3.1 per cent, but it slashed its prediction for next year to 0.9 per cent and trimmed the one for 2024 to 1.9 per cent.

Recommended: Markets InsightTony Barber- A forceful ECB rate rise may fail to curb market tensions. However, unlike many economists, the bank does not expect a recession — two consecutive quarters of falling output — instead predicting the economy would "stagnate later in the year and in the first quarter of 2023" in its baseline scenario.

A bleaker forecast, devised by the central bank and which assumes a drastic worsening of Europe's energy crisis, does foresee the eurozone economy shrinking 0.9 per cent next year. Lagarde said some risks in the downside scenario had already materialised, such as Russia halting gas flows via the Nord Stream 1 pipeline that runs under the Baltic Sea to Germany.

The central bank raised its inflation forecasts sharply to 8.1 per cent for this year, to 5.5 per cent for next year and to 2.3 per cent for 2024. Carsten Brzeski, head of macro research at ING Bank, said: "It is still hard to see how the ECB can bring down inflation that is mainly driven by supply side factors."

The ECB said its main refinancing rate for bank liquidity would increase from 0.5 per cent to 1.25 per cent. The rate on its marginal lending facility for overnight loans to banks would rise from 0.75 per cent to 1.5 per cent.

The bank also took measures to ease shortages of high-quality and liquid collateral, removing a zero per cent cap on interest for government deposits, which analysts said would avoid much of the €600bn covered by the change shifting into short-term government debt.

10.8.1. How Does The European Central Bank (ECB) Works?

The Team of ECB consists of 6 Executive members plus the Governors of the central bank of all the member states plus the president and vice-president.

1. The team ensures the performance of their states' banking system as per the guidelines.
2. The Monetary Policy is framed with suggestions and reviews from all the team members and based on a market survey.
3. The team of banks ensures the member states follow the guidelines issued by the bank by inspection, audit, and report on this behalf.
4. Then, the team meets twice a month and discusses the various reports onwsm-tooltip header="Compliance And Audit" description="Compliance Audit is a detailed review of organization's compliance towards statutory laws, local laws, internal rules, and decisions of the organization as applicable." url="https://www.wallstreetmojo.com/compliance-audit/"]compliance and audit[/wsm-tooltip].
5. It segregates the responsibilities amongst the members, and members ensure compliance and monitor the guidelines.
6. Then, after the discussion on the reports, the final report is sent to all the members consisting of the reviews by the team, their drawbacks, and suggestions to improve.
7. The president and vice-president approve the final report.

10.8.2. Central Bank Losses Risk Opening Old Eurozone Faultlines

FRANKFURT — The eurozone's sovereign debt crisis was driven by the fiscal largesse of the bloc's most profligate nations. A decade on, it is the central banks of the Eurozone's strongest economies, such as the German Bundesbank, that are expected to slide into the red even as the weaker members' central banks stay in profit. The scope of the losses will be revealed over the next few weeks as the eurozone's respective national central banks (NCBs) present their annual reports. On Thursday, the European Central Bank (ECB) kicked off the earnings parade with a €1.6 billion loss its first in almost two decades. Even so, the ECB balance sheet only reflects a fraction of the Eurosystem's monetary policy operations, most of which are conducted by the region's NCBs. Many of these, including the Bundesbank — which will report on March 1 — are expected to reveal even larger losses.

That loss-making trend is set to continue with the NCBs of other fiscally prudent countries, among them the Netherlands, Austria and Finland — which were most skeptical of measures now leading to losses, generating a mirror image of the north-south rupture of the original eurozone sovereign debt crisis. Some fear the role reversal could reopen the old wounds of the debt crisis that once pitched eurozone government against government, while inflaming public sentiment and casting serious questions about the viability of the euro currency. "The hit on southern central banks is much smaller and you can bet on it that this will raise tensions," said Johan Van Overtveldt, the Belgian chair of the EU Parliament's budget committee. The impending losses of the region's central banks "will surface in practically every discussion, directly or indirectly." During the sovereign debt crisis, the taxpayers from northern Europe often felt they had to pay for the fiscal recklessness of their southern neighbors.

No risk-sharing means no loss-sharing

In normal profitable times, the ECB usually passes its gains to NCBs, which in turn hand their overall profit-takes to their respective governments. In the past, the ECB has generated as much as €2.4 billion to share with NCBs in this way, while NCBs have been known to rake in as much as €6.3 billion on an individual basis. To guard against any threat to public balance sheets in the event of losses, most central banks — including the ECB — maintain large provision funds to absorb shortfalls. These are rarely tapped, but this year the ECB's Governing Council was forced to dip into the last-resort measure to keep its accounts tidy. "There will be no profit distribution to the euro area national central banks," the ECB said.

The headquarters of the European Central Bank (ECB) pictured in Frankfurt | Daniel Roland/AFP via Getty Images

Other loss-generating NCBs are expected to follow suit in tapping their provision funds, and in some cases may eventually even wipe them out entirely. The balance sheet pressure has revived concerns about the sustainability of eurozone cohesion. Analysts suggest northern eurozone members only have themselves to blame for any fiscal exposures pertaining to bond purchases, particularly because they made a point of shielding themselves from the risk of southern member state defaults. "The northerners insisted on no risk-sharing when the PSPP [the public sector purchase program] started," said Daniel Gros, an economist and board member of the Centre for European Policy Studies, referring to the trillions of euros the ECB spent on government bonds. "This means now also no loss-sharing."

The potential political explosiveness of losses was highlighted last week when the Financial Times published an op-ed by Professor Markus Kerber, an influential Euroskeptic, who warned they could "undermine public confidence in the euro, especially in Germany," and that "we may now be approaching a necessary moment of truth for the central bank."

What's driving the losses?

The ECB and the wider Eurosystem are not alone among major international counterparts in recording hits to their balance sheets. The combined forces of inflation and higher interest rates have been a drag on many Western central banks. In the eurozone, however, the added pressure of managing losses within the framework of a single monetary system and no fiscal union means the costs will not be spread equally among member states. Much of the stress — as well as the divergence — is related to the massive support measures central banks took to prevent the eurozone from falling apart during the sovereign debt crisis, as well as to thwart an economic crisis during the global pandemic. For the Bundesbank, what was once a German strength — the capacity of its government to borrow at negative interest rates due to the relative health of its economy — has become a burden. The Bundesbank is now having to bear the cost of a mountain of negative-yielding assets acquired as a result of its asset purchases, meaning it has to pay its Treasury for the privilege of holding German government bonds.

The NCBs of weaker countries, on the other hand, stand to benefit from the generous positive yields they picked up when the debt of their respective governments was highly distressed.The ECB’s own performance has been hit by foreign exchange effects on its dollar holdings and payments linked to the management of the Target2 settlement system. One other loss-generating factor stems from the effect that rising interest rates have on the sums central banks must pay to commercial banks holding excess liquidity in their deposit facilities. As interest rates go up, these sums grow ever larger. Since excess liquidity tends to flow to economically stronger member states, this compounds the problem by causing the NCBs of stronger states to warehouse a larger share of increasingly heavily remunerated deposits.

10.9. SUMMARY

After studying this lesson student should be able to Know about the History of European Central Bank. Explain for Objectives, Functions of the European Central Bank. Understand Organization structure of European Central Bank (ECB). The European Central bank is the controlling bank of all the member states. Currently, 27 European countries are members of the ECB. The main aim behind establishing the bank is to maintain the price stability of the currency adopted by all the members, i.e., the Euro in the international market. The bank is also responsible for issuing guidelines, monitoring the banking system, controlling inflation and unemployment, and maintaining price stability. The structure consists of the president and vice-president as the chairpersons and Governors of all the member states and the other six executives as the Governing Committee. There are various committees under the Governing committee through which compliance is ensured. The loopholes and suggestions are communicated to the member states through the audit reports and compliance reports. The committee of the European central bank meets twice a month to ensure smooth conduct and to formulate and discuss the plans for achieving the various objectives, which ensures the growth of the member countries.

10.10. TECHNICAL TERMS

European Central Bank: The European Central Bank (ECB) is the central bank responsible for monetary policy of the European Union (EU) member countries that have adopted the euro currency. This currency union is known as the eurozone and currently includes 19 countries. The ECB's primary objective is pricestability in the euro area.

Inflation: Inflation is a quantitative measure of the rate at which the average price level of a basket of selected goods and services in an economy increases over a period of time.

Unemployment: The term unemployment refers to a situation where a person actively searches for employment but is unable to find work. Unemployment is considered to be a key measure of the health of the economy.

International market: According to the American Marketing Association, international marketing is a multinational process of planning and executing the conception, pricing, promotion, and distribution of ideas, goods, and services to create an exchange that satisfies individual and organizational objectives. It's somewhat similar to export management.

10.11. SELF ASSESSMENT QUESTIONS

1. Briefly explain about the History of European Central Bank.
2. Define European Central Bank.What are the objectives of it?
3. What is the role and responsibilities of European Central Bank?
4. Explain the functions of European Central Bank.
5. Discuss about the Organization structure of the European Central Bank.
6. How Does The European Central Bank (Ecb) Works?-Briefly explain.

10.12. SUGGESTED READINGS

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7. Written by CFI Team- Updated December 27, 2022. By ADAM HAYES Updated May 31, 2022
8. Reviewed by ERIKA RASURE.
9. Fact checked by KIRSTEN ROHRS SCHMITT

Dr. Krishna Banana

LESSON-11
BANK OF JAPAN

AIMS AND OBJECTIVES

After studying this lesson student should be able to

- Know about the Structure and Ccommercial banking system
- Understand for Economic Activity and Prices
- Explain the Role of Japan Monetary Policy July 2021

STRUCTURE

11.1. INTRODUCTION

According to its charter, the missions of the Bank of Japan are. Issuance and management of banknotes. Implementation of monetary policy. Providing settlement services and ensuring the stability of the financial system. Treasury and government securities-related operations. International activities. The wide street in front of the bank is part of the Mido-Suji. Since its Meiji era beginnings, the Bank of Japan has operated continuously from main offices in Tokyo and Osaka. The Bank of Japan was reorganized in 1942 [4] (fully only after 1 May 1942), under the Bank of Japan Act of 1942 (日本銀行法 昭和17年法律第67号), promulgated on 24 February 1942. The Bank of Japan announced a tweak to its interest rate policies, allowing ten-year bond yields to rise. It also announced an increase in its bond-buying program. Overall, stocks fell on the news, and the yen spiked in value as investors worldwide expressed fear over the end of easy money policies across the globe.

Bank of Japan (BOJ) Definition: The Bank of Japan (BOJ) is headquartered in the Nihonbashi business district in Tokyo. The BOJ is the Japanese central bank, which is responsible for issuing and handling currency and treasury securities, implementing monetary policy, maintaining the stability of the Japanese financial system, and providing settling and clearing services. Like most central banks, the BOJ also compiles and aggregates economic data and produces economic research and analysis. The Bank of Japan, or BOJ, is Japan's central bank; it has been operational since 1885—when it first issued currency. The BOJ is responsible for determining monetary policy, setting interest rates, and issuing and monitoring currency and treasury securities. The Bank of Japan also compiles economic data, conducts research and analysis, and makes the information available to the public.

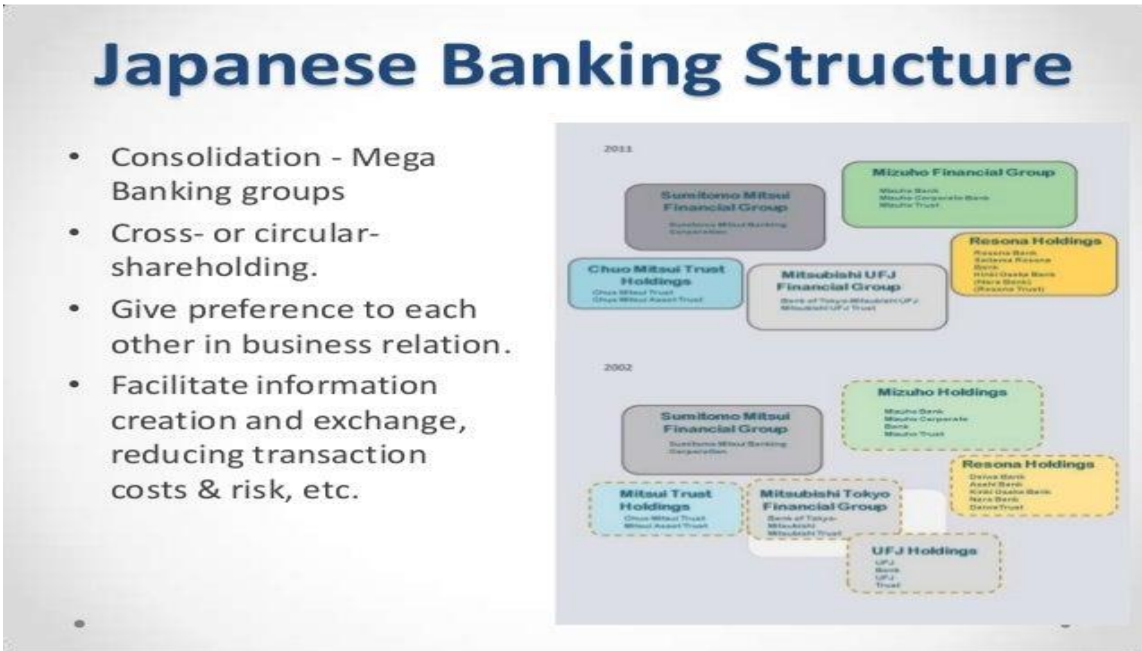
Organization of the Bank of Japan: The bank is headed by the governor, who was Haruhiko Kuroda as of September 2022. Kuroda was nominated in 2013, was the 31st governor of the BOJ, and was formerly the President of the Asian Development Bank. He was reappointed for a five-year term in April 2018. Kuroda is an advocate of looser monetary policy. There are also two deputy governors, six members of the Policy Board, three or fewer auditors, "a few" counselors, and six or fewer executive directors heading the BOJ. All of these officers belong to the bank's Policy Board, which is the Bank's decision-making body. The Board sets currency and monetary controls, the basic principles for the Bank's operations, and oversees the duties of the Bank's officers, excluding auditors and counselors. The Policy Board includes the governor and the deputy governors, auditors, executive directors, and counselors. There are 15 departments at the Bank's head office, 32 branches, and 14 local offices.

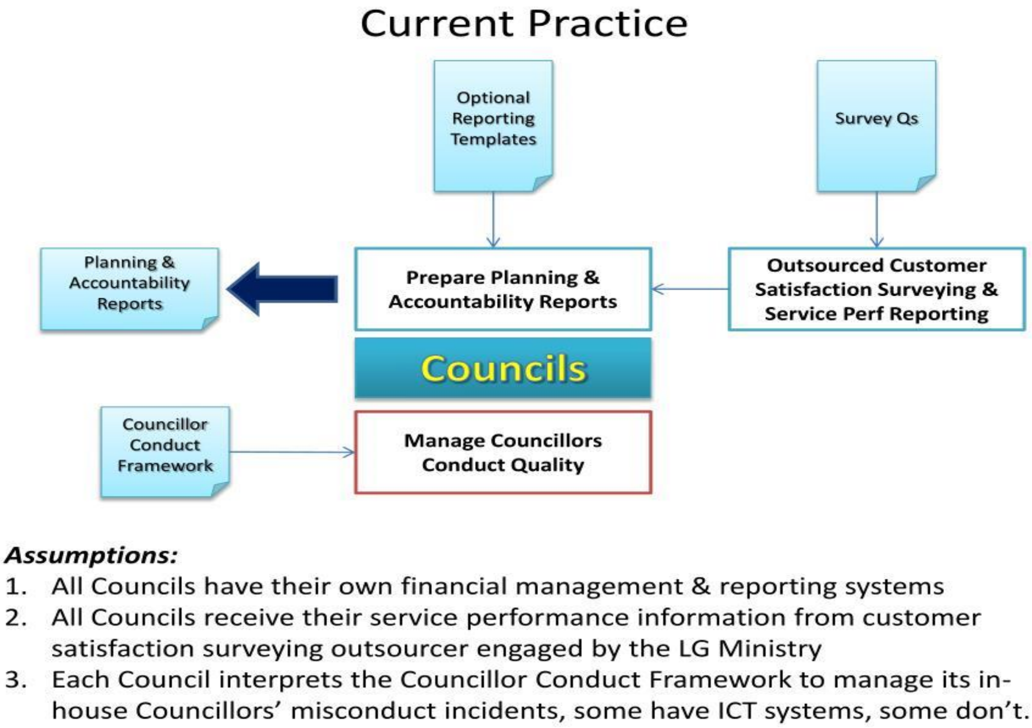
Monetary Policy: The Bank of Japan decides and implements monetary policy to maintain price stability. The Bank manipulates interest rates for the purpose of currency and monetary control using operational instruments, such as money market operations. Monetary policy is decided by the Policy Board at Monetary Policy Meetings (MPMs). At MPMs, the Policy Board discusses the nation's economic and financial situation, sets the guidelines for money market operations, and the Bank's monetary policy stance for the immediate future. MPMs are held eight times a year for two days. Monetary policy decisions are made by a majority vote of the nine members of the Policy Board, which consists of the Governor, the two Deputy Governors, and the six other members. The bank uses in-depth research and analysis on economic and financial conditions when deciding monetary policy.

Independence and Transparency: The BOJ immediately releases its decisions on monetary policy after each MPM. The bank also holds regular press conferences by the chair of the Policy Board—the Governor—to explain monetary policy decisions. The Bank also releases the Summary of Opinions at each MPM and the minutes of MPMs. The bank also releases its transcripts 10 years later to provide transparency regarding Policy Board decisions.

11.2. STRUCTURE & COMMERCIAL BANKING SYSTEM OF JAPAN

The main elements of Japan's financial system are much the same as those of other major industrialized nations: a **commercial banking system**, which accepts deposits, extends loans to businesses, and deals in foreign exchange; specialized government-owned financial institutions, which fund various sectors of the domestic economy; securities companies, which provide brokerage services, underwrite corporate and government securities, and deal in securities markets; capital markets, which offer the means to finance public and private debt and to sell residual corporate ownership; and money markets, which offer banks a source of liquidity and provide the Bank of Japan with a tool to implement monetary policy.





Banks: Japan's traditional banking system was segmented into clearly defined components in the late 1980s: commercial banks (thirteen major and sixty-four smaller regional banks), long-term credit banks (seven), trust banks (seven), mutual loan and savings banks (sixty-nine), and various specialized financial institutions. During the 1980s, a rapidly growing group of nonbank operations—such as consumer loan, credit card, leasing, and real estate organizations—began performing some of the traditional functions of banks, such as the issuing of loans.

In the early postwar financial system, city banks provided short-term loans to major domestic corporations while regional banks took deposits and extended loans to medium-sized and small businesses. Neither engaged much in international business. In the 1950s and 1960s, a specialized bank, the Bank of Tokyo, took care of most of the government's foreign-exchange needs and functioned as the nation's foreign-banking representative. Long-term credit banks were intended to complement rather than to compete with the commercial banks. Authorized to issue debentures rather than take ordinary deposits, they specialized in long-term lending to major keiretsu (系列).

Trust banks were authorized to conduct retail and trust banking and often combined the work of commercial and long-term credit banks. Trust banks not only managed portfolios but also raised funds through the sale of negotiable loan trust certificates. Mutual loan and savings banks, credit associations, credit cooperatives, and labor credit associations collected individual deposits from general depositors. These deposits were then loaned to cooperative members and to the liquidity-starved city banks via the interbank money markets or were sent to central cooperative banks, which in turn loaned the funds to small businesses and corporations. More than 8,000 agricultural, forestry, and fishery cooperatives performed many of the same functions for the cooperatives. Many of their funds were transmitted to their central bank, the Norinchukin Bank, which was the world's largest bank in terms of domestic deposits.

Government institutions: A group of government financial institutions paralleled the private banking sector. The Japan Export-Import Bank (JEXIM), the Japan Development Bank, and a number of finance corporations, such as the Housing Loan Corporation, promoted the growth of specialized sectors of the domestic economy. These institutions derived their funding from deposits collected by the postal savings system and deposited with the Trust Fund Bureau. The postal savings system, through the 24,000 post offices, accepted funds in various forms, including savings, annuities, and insurance. The post offices offered the highest interest rates for regular savings accounts (8% for time deposits in 1990) and tax-free savings until 1988, thereby collecting more deposits and accounts than any other institution in the world.

The Japan Bank for International Cooperation (JBIC) is the only government institution with an international focus. This bank provides financing for trade between Japan and developing countries, performing the function of export-import banks run by governments in other countries (including the United States), although its participation is possibly greater.

Securities: Japan's securities markets increased their volume of dealings rapidly during the late 1980s, led by Japan's rapidly expanding securities firms. There were three categories of securities companies in Japan, the first consisting of the "Big Four" securities houses (among the six largest such firms in the world): Nomura, Daiwa, Nikko, and Yamaichi. The Big Four played a key role in international financial transactions and were members of the New York Stock Exchange. Nomura was the world's largest single securities firm; its net capital, in excess of US$10 billion in 1986, exceeded that of Merrill Lynch, Salomon Brothers, and Shearson Lehman combined. In 1986, Nomura became the first Japanese member of the London Stock Exchange. Nomura and Daiwa were primary dealers in the United States Treasury bond market. The second tier of securities firms contained ten medium-sized firms. The third tier consisted of all the smaller securities firms registered in Japan. Many of these smaller firms were affiliates of the Big Four, while some were affiliated with banks. In 1986 eighty-three of the smaller firms were members of the Tokyo Securities and Stock Exchange. Japan's securities firms derived most of their income from brokerage fees, equity and bond trading, underwriting, and dealing. Other services included the administration of trusts. In the late 1980s, a number of foreign securities firms, including Salomon Brothers and Merrill Lynch, became players in Japan's financial world.

Japanese insurance companies became important leaders in international finance in the late 1980s. More than 90% of the population owned life insurance and the amount held per person was at least 50% greater than in the United States. Many Japanese used insurance companies as savings vehicles. Insurance companies' assets grew at a rate of more than 20% per year in the late 1980s, reaching nearly US$694 billion in 1988. The life insurance companies moved heavily into foreign investments as deregulation allowed them to do so and as their resources increased through the spread of fully funded pension funds. These assets permitted the companies to become major players in international money markets. Nippon Life Insurance Company, the world's largest insurance firm, was reportedly the biggest single holder of United States Treasury securities in 1989.

Stock Exchange: The Tokyo Securities and Stock Exchange became the largest in the world in 1988, in terms of the combined market value of outstanding shares and capitalization, while the Osaka Stock Exchange ranked third after those of Tokyo and New York. Although there are eight stock exchanges in Japan, the Tokyo Securities and Stock Exchange represented 83% of the nation's total equity in 1988. Of the 1,848 publicly traded domestic companies in Japan at the end of 1986, about 80% were listed on the Tokyo Securities and Stock Exchange.

Two developments in the late 1980s helped in the rapid expansion of the Tokyo Securities and Stock Exchange. The first was a change in the financing of company operations. Traditionally large firms obtained funding through bank loans rather than capital markets, but in the late 1980s they began to rely more on direct financing. The second development came in 1986 when the Tokyo exchange permitted non-Japanese brokerage firms to become members for the first time. By 1988 the exchange had sixteen foreign members. The Tokyo Securities and Stock Exchange had 124 member companies in 1990. In 1990, five types of securities were traded on the Tokyo exchange: stocks, bonds, investment trusts, rights, and warrants alone.

Japan's stock market dealings exploded in the 1980s, with increased trading volume and rapidly rising stock prices. The trading recorded by the Nikkei 225 stock average, compiled by the Nihon Keizai Shimbun (Japan Economic Daily), grew from 6,850 in October 1982 to nearly 39,000 in early 1990. During one six-month period in 1986, total trade volume on the Tokyo exchange increased by 250% with wild swings in the Nikkei. After the plunge of the New York Stock Exchange in October 1987, the Tokyo average dropped by 15%, but there was a sharp recovery by early 1988. This was the height of the Japanese asset price bubble, which collapsed in the year 1990, and was followed by the lost decade.

11.2.1. BOJ Says Japan's Banking System Stable, Warns Of Risks

A man wearing a protective mask walks past the headquarters of the Bank of Japan amid the coronavirus disease (COVID-19) outbreak in Tokyo, Japan, May 22, 2020.REUTERS/Kim Kyung-Hoon

1. Overseas credit risk contained but some sign of worsening – BOJ
2. Rise in U.S. yields to hurt Japan banks' capital adequacy ratio
3. BOJ urges banks to diversify dollar funding instruments

TOKYO, Oct 21 (Reuters) - Japan's banking system remains broadly stable but financial institutions could face risks including from a possible increase in credit costs caused by a delay in the economic recovery, the Bank of Japan (BOJ) said in a report on Thursday. Financial institutions also risk incurring losses on their securities investment portfolios in the event of a rapid market adjustment, the BOJ said, adding the central bank must remain vigilant. "Credit risk of overseas loans is generally contained as overseas economies recover on the whole. Nevertheless, there are signs of deterioration in some portfolios that seem to be severely affected by the pandemic," said the BOJ in its semi-annual report analysing Japan's banking system. Stress tests highlighted the vulnerability of Japanese banks to potential market swings caused by an expected withdrawal of U.S. monetary stimulus, the report showed.

Latest Updates

1. Flooding in southern Malaysia forces 40,000 people to flee homes
2. Hong Kong court convicts 3 members of Tiananmen vigil group for security offence
3. Indonesian officials call for audit after Pertamina fire kills 15
4. China parliament to vote on state reform plan, new Cabinet
5. North Korea says UN should demand end to S.Korea-US military drills

Markets expect the Federal Reserve to announce bond tapering plans in November with some projecting an interest rate hike as early as next year. Under a scenario where U.S. long-term interest rates rise 100 basis points and hurt emerging economies, big Japanese banks with global operations will see their capital adequacy ratio slide to 9.6% in fiscal 2023 from the current 12.5%, the report said. A further worsening of Japan's economy could deal a heavy blow to banks focusing on domestic operations with their capital adequacy ratio seen falling to 9.5% from 10.1%, the report showed. "In the event of a substantial and rapid adjustment in global financial markets, financial institutions' health may deteriorate and disrupt financial intermediation that could then further hurt Japan's economy," the report said. The BOJ also urged Japanese banks operating globally to diversify ways to procure dollar funds as they expand overseas investment and lending.

11.3. BANK OF JAPAN CHIEF NOMINEE STICKING TO FAMILIAR PLAYBOOK, AT LEAST FOR NOW- March 4, 2023 (Mainichi Japan)

Bank of Japan governor nominee Kazuo Ueda speaks at a House of Councillors steering committee meeting in parliament in Tokyo on Feb. 27, 2023. (Kyodo) TOKYO (Kyodo) -- Bank of Japan governor nominee Kazuo Ueda is signaling that financial markets should not expect big surprises or magical solutions, as he braces for the monumental challenges facing the central bank. His carefully worded statements on monetary policy in his recent confirmation hearings in parliament suggest he will prioritize communication with financial markets and make his thinking behind policy decisions clear.

Ueda, 71, has cast himself as a future BOJ policymaker, who would be realistic, flexible, and also creative in guiding monetary policy after a decade of monetary easing under incumbent Haruhiko Kuroda has exposed its side effects. For now, he said the BOJ's monetary easing is appropriate and should continue as its 2 percent inflation target has yet to be attained in a stable and sustainable way. Still, the academic and former BOJ board member has left hopes alive for a review of the central bank's program to keep borrowing costs low to support the economy, known as "yield curve control."

Market participants have taken Prime Minister Fumio Kishida's surprise selection of Ueda as a sign of a gradual departure from the late former premier Shinzo Abe's "Abenomics" economy-booster program that had bold monetary easing as a key pillar. "Mr. Ueda wants to overhaul YCC by looking at (upcoming) economic data, particularly wages, which will certainly become a defining moment," said Hideo Kumano, executive chief economist at Dai-ichi Life Research Institute. "What matters is how things get off to a start, so April will be key," he added, referring to the BOJ's first meeting to be held under its new governor next month.

In response to questions from lawmakers in both houses of parliament, Ueda took the view that the BOJ is still seeking to examine the effect of a December decision to raise the ceiling on 10-year Japanese government bond yields, which stunned financial markets. The move fueled market expectations of further tweaks down the road and a shift to a tighter monetary policy despite the central bank's insistence that it was aimed at fixing market distortions. The market views added upward momentum to 10-year bond yields and the BOJ has had to ramp up bond buying to defend the ceiling as the decision apparently backfired. Bond prices and yields move inversely.

Adopted in 2016, YCC sets short-term interest rates at minus 0.1 percent and guides 10-year bond yields around zero percent. Ueda, who will take the helm of the BOJ in April if parliament gives the go-ahead this month, only said he will take time and determine "what it should look like" in consultation with BOJ staff and other board members. Ueda did not make outright commitments that would limit room for future policy maneuver, largely playing it safe but also giving certain reassurances to both proponents and critics of monetary easing under Kuroda, the BOJ's longest-serving governor."Mr. Ueda so far fended off pressure from politicians demanding a continuation of reflationary policy. But his statement that he will put the finishing touches to the mission of attaining price stability shows his resolve to eventually begin an exit strategy," Kumano said. Improving economic conditions, especially accelerating inflation in Japan, are also strengthening the view among some market players that a policy change is in the offing.

Japan's key gauge of inflation, the core consumer price index excluding volatile fresh food items, was at a 41-year high of 4.2 percent in January and stayed above the BOJ's 2 percent target for 10 months. If the inflation rate is expected to reach 2 percent, "We will have to normalize powerful monetary steps that are in place. At this point, however, I refrain from explaining what that means, when and how we will normalize them," Ueda said, as he expects the core CPI to fall below the target later this year. Market participants expect 10-year Japanese government bond yields to hit 0.67 percent on average at the end of June, higher than 0.5 percent forecast in March, according to a BOJ survey of financial institutions.

The would-be governor also said that the 2 percent inflation target and a 2013 statement committing the BOJ to attaining the goal as soon as possible should be maintained at least for the time being. Some experts and lawmakers have demanded that they be changed, which would signal a break with the Kuroda era. Hiroshige Seko, a ruling party lawmaker and supporter of Abe's reflationary policy mix, said revising the accord would be like opening Pandora's box. "How determined are you that you will carry on with Abenomics?" Seko pressed Ueda during a confirmation hearing.

Ueda said he is keenly aware of the gravity of the challenge facing the BOJ that does not allow for "wrong judgments" by the next governor, adding he wants to utilize his experience as a board member and academic. Ueda, who taught as a professor at the University of Tokyo, is currently teaching at Tokyo's Kyoritsu Women's University. "At the end of the day, how the BOJ wants to remove YCC and communicate it (to financial markets) is important," said Toru Suehiro, chief economist at Daiwa Securities, adding that scrapping YCC will not come before this summer. Economists at Daiwa Institute of Research estimate that doubling the current range of minus 0.5 percent and 0.5 percent for 10-year bond yields will push down real gross domestic product by around 0.2 percent. If YCC is scrapped, GDP will suffer a bigger negative impact of 0.5 percent. Ryutaro Kono, chief Japan economist at BNP Paribas in Japan, said the 10-year yield ceiling could be raised to 1 percent at a policy-setting meeting from Thursday, Kuroda's last.

11.4. ECONOMIC ACTIVITY, PRICES, AND MONETARY POLICY IN JAPAN

Speech at a Meeting with Local Leaders in Gunma I. Economic Activity and Prices
A. Economic Activity

1. Current Situation: I will begin my speech by talking about recent developments in economic activity in Japan. Japan's economy, despite being affected by factors such as high commodity prices, has picked up as the resumption of economic activity has progressed while public health has been protected from COVID-19. The pace of recovery had remained moderate in Japan, partly because steps to resume economic activity had been taken more cautiously than in other advanced economies; nevertheless, real GDP growth has almost recovered to levels seen before the pandemic (Chart 1). Let me explain the current state of Japan's economy in more detail. First, a look at the household sector. Although Japan experienced the eighth wave of the pandemic this winter, the impact on private consumption has been limited compared with past cases, and private consumption continues to recover as a trend from the downturn brought about by the impact of the pandemic (Chart 2). This recovery trend has been supported by pent-up demand on the back of household savings that had accumulated during the pandemic and by the government's domestic travel discount program. Next, the corporate sector. Exports and production have increased as a trend, supported in part by high levels of order backlogs, with the effects of supply-side constraints waning (Chart3). By goods, exports of automobile-related goods have increased moderately, as the tightness in global supply and demand conditions for semiconductors used in automobiles has gradually eased. Those of capital goods have increased, supported by high levels of order backlogs. In contrast, exports of IT-related goods such as semiconductors have been somewhat weak, with stronger adjustment pressure on those for smartphones and personal computers. As for corporate profits, while there are differences across industries and firm sizes, and despite having declined slightly recently, they have been at a historically high level on the whole, exceeding the level seen before the pandemic (Chart 4). By firm size, while corporate profits of large firms have been on a rising trend, those of small and medium-sized firms have been more or less flat. The business fixed investment stance has been active in both manufacturing and nonmanufacturing, due in part to pent-up demand for investments that had been restrained during the pandemic.

2. Outlook: Next, I will turn to the outlook for economic activity. Economies in Europe and the United States are expected to slow against the background of significant policy interest rate hikes by central banks to contain rapid inflation (Chart 5). Meanwhile, Japan's economy is likely to recover, with the impact of COVID-19 and supply-side constraints waning and with support from accommodative financial conditions and the government's economic measures, although it is expected to be under downward pressure stemming from high commodity prices and slowdowns in overseas economies. In fact, the International Monetary Fund (IMF) projected in its January 2023 World Economic Outlook (WEO) Update that

Japan would achieve the highest growth among the G7 countries in 2023 (Chart 6). As background to Japan's economic outlook, the following are five key developments. First, the waning of supply-side constraints will make a positive contribution to exports and production. Second, pent-up demand, which has recently been pushing up private consumption and business fixed investment, will continue to support the economy's recovery for the time being. Third, inbound tourism demand will increase, reflecting the government's relaxation of entry restrictions. Fourth, with corporate profits remaining at high levels on the whole, business fixed investment -- including that to address labor shortage, digital-related investment, and that related to growth areas and decarbonization -- will continue to increase. Fifth, as wage growth increases, reflecting tightening labor market conditions and price rises, a virtuous cycle from income to spending will intensify gradually. Taking these points into account,IexpectthatJapan'economywillrecover.

In terms of the medians of the Bank of Japan Policy Board members' forecasts -- as presented in the January 2023 Outlook for Economic Activity and Prices (Outlook Report) -- Japan's real GDP growth rate is expected to be at 1.9 percent for fiscal 2022, 1.7 percent for fiscal 2023, and 1.1 percent for fiscal 2024 (Chart 7). As Japan's recent potential growth rate is estimated to be in the range of 0.0-0.5 percent, the economy is projected to continue growingat a pace above its potential. However, the pace of growth is expected to decelerate gradually because the outlook factors in the government's economic measures and their waning effects, in addition to a weakening contribution from pent-up demand. There are extremely high uncertainties regarding the outlook. Those that especially warrant attention are (1) developments in overseas economic activity and prices and in global financial and capital markets, (2) developments in the situation surrounding Ukraine and their effects on the price of commodities, including grain, and (3) the impact of COVID-19 on the economy. In view of these factors, while there are upside and downside risks to the outlook, the Bank assesses that risks are skewed to the downside for the time being.

B. Price Developments: Turning to Japan's price developments, the year-on-year rate of increase in the consumer price index (CPI) for all items less fresh food was 4 percent for December 2022 (Chart 8). Inaddition to higher energy prices, for goods, the pass-through of cost increases to selling prices has intensified for a wide range of items, especially food, daily necessities, and durable goods. The rate of increase in general services prices has also accelerated against the backdrop of an intensified pass-through of raw material costs, mainly for housework-related services, including services related to housing repairs and maintenance, as well as dining-out. Such price increases have been triggered by a rise in import prices, reflecting high commodity prices and the yen's depreciation. However, what is distinctive about the current phase is the change in firms' price-setting stance. In Japan, it had been difficult for firms to pass on cost increases to selling prices even when faced with a rise in input prices. However, this situation has started to change: firms -- even those that had taken a cautious stance toward changingtheir selling prices -- have sought price hikes, while their pricing decisions have been made in consideration of price setting by competitors (Chart 9). Furthermore, according to the Tankan (Short-Term Economic Survey of Enterprises in Japan), firms' outlook for output prices of their products for one year ahead has been higher than that for general prices in the most recent surveys. These mark the first time this has been observed since the launch of the survey in 2014, which can be viewed as indicating that firms' stance has shifted toward actively raising their selling prices.

The outlook for prices also entails high uncertainties, and risks to prices are skewed to the upside for the time being. In my opinion, we cannot deny the possibility that prices will rise more than expected, given that firms' pass-through of cost increases to selling prices is ongoing and inflation momentum has continued, and that the pace of rises in services prices is accelerating gradually. Thus, it is necessary to continue to closely monitor price developments going forward.

C. Conduct of Monetary Policy

A. Achieving the Price Stability Target in a Sustainable and Stable Manner Now, I would like to turn to the Bank's conduct of monetary policy. The Bank conducts monetary policy with the aim of achieving the price stability target in a sustainable and stable manner. About 10 years ago, when Japan was struggling with deflation, the Bank set the price stability target at 2 percent in terms of the year-on-year rate of change in the CPI, and has since carried out large-scale monetary easing aimed at achieving this target. The current framework for monetary easing, called Quantitative and Qualitative Monetary Easing (QQE) with Yield Curve Control, consists of two components (Chart 11). The first is yield curve control, which involves controlling short- and long-term interest rates through market operations. The second is an inflation-overshooting commitment, in which the Bank has committed to continuing to expand the monetary base until the year-on-year rate of increase in the observed CPI exceeds the price stability target of 2 percent and stays above the target in a stable manner, thereby strengthening people's confidence that the target will be achieved. Specifically, yield curve control entails setting the short-term policy interest rate at nus 0.1 percent, while conducting purchases of Japanese government bonds (JGBs) and other operations for the long-term interest rate to ensure that 10-year JGB yields remain at around 0 percent. The Bank's monetary easing assumes a transmission mechanism that works in three ways (Chart 12): (1) nominal interest rates are pushed down through yield curve control; (2) inflation expectations are raised by working on people's expectations through the inflation-overshooting commitment, leading to a decline in real interest rates (i.e., nominal interest rates less inflation expectations); and (3) lower real interest rates encourage economic activity and improve the output gap, which in turn pushes up actual inflation.

After almost 10 years since the Bank began large-scale monetary easing, Japan's economy has achieved a situation where it is no longer in deflation, in the sense of a sustained decline in prices (Chart 13). The output gap had continued to improve, clearly turning positive, until the economy was significantly affected by downward pressure stemming from the impact of COVID-19; it picked up thereafter and has returned to a level where it is poised to turn positive once again. In addition, the employment situation has improved, as evidenced by, for example, a continued decline in the unemployment rate. Successive increases in base pay, which were not seen during the deflationary period, have also been observed. As I mentioned earlier, however, the Bank projects that inflation will fall below 2 percent, and we are not yet at a point where the price stability target of 2 percent is achievable in a sustainable and stable manner. Furthermore, an important perspective would be to not simply examine how superficial figures develop but to consider whether an economic virtuous cycle is created in which price rises are backed by increases in corporate sales and profits and by wage hikes. At this juncture, whether wages will rise at a pace consistent with the ongoing significant rise in consumer prices would seem to be particularly critical in terms of achieving the price stability target in a sustainable and stable manner, and the outcome of the labor-management wage negotiations in spring 2023 warrants attention (Chart 14). While the context may differ among individual firms, my view is that there is a certain degree of possibility that relatively,,,,,,high wage increases will be achieved in light of (1) a positive stance toward wage hikes among the government, labor, and management; (2) generally favorable corporate profits; (3) the labor-management relations in Japan, where there is a strong tendency to support each other; and (4) the labor shortages in the face-to-face services industry and among small and medium-sized firms. To share my perspective regarding the conduct of monetary policy for the immediate future,I see Japan's economy currently being in a rare situation, in which pent-up demand is underpinning economic activity even as the rise in consumer prices has been triggered by the rise in import prices. Given this situation, I believe that we are at a stage now where it is necessary to carefully monitor whether a virtuous cycle between wages and prices will be achieved in Japan. For the moment, therefore, I consider it appropriate for the Bank to continue with monetary easing.

B. Side Effects of Large-Scale Monetary Easing: The Bank has carried out large-scale monetary easing while striking a balance between its positive effects and side effects. Next, I would like to turn to some of the side effects. The first is the deterioration in market functioning. At its Monetary Policy Meeting (MPM) held last December, the Bank modified its conduct of yield curve control in light of this side effect. Let me explain the nature and background of the modification (Chart 15). Since early
spring 2022, the JGB yield curve had been under significant upward pressure, in a situation where overseas central banks raised policy interest rates and consumer prices rose in Japan. While the Bank had been purchasing a necessary amount of long-term JGBs so that 10-year JGB yields stayed within the range of plus and minus 0.25 percentage points from 0 percent, upward pressure on interest rates had frequently caused long-term interest rates to remain at the 0.25 percent upper limit. In this situation, yields on bonds with 8- and 9-year maturities were higher than on 10-year bonds, and a price gap was observed between futures and spot markets. In addition, while the yields for the most recent issues of 10-year JGBs had been at 0.25 percent or lower, issues of 20-year JGBs with a residual maturity of 10 years were trading at higher yields. Amid such distortions in the yield curve, a survey of market participants conducted by the Bank found a growing perception that the functioning of the JGB market was deteriorating.

JGB yields serve as reference rates and indicators for corporate bond yields, bank lending rates, and other funding rates. If such distortions persist, they could negatively impact financial conditions, such as issuance conditions for corporate bonds. With this in mind, the Bank decided to modify its conduct of yield curve control in order to improve market functioning, while maintaining accommodative financial conditions. Concretely, while significantly increasing the amount of JGB purchases, the Bank expanded the range of 10-year JGB yield fluctuations frosmoothly, such as through corporate financing. It will take more time to assess the impact of the modifications on market functioning. At this stage, I believe it is critical to humbly and carefully monitor how markets settle, and to what extent market functioning improves. Regarding this modification of the conduct of yield curve control, many have questioned whether this was not a de facto interest rate hike or have said that the Bank's explanation of why this was actually not an interest rate hike was hard to follow. To be sure, long-term interest rates are rising. However, I would like to stress once again that these measures are meant to alleviate the side effects of monetary easing and make it sustainable, and are not intended as a move toward monetary tightening.
The second side effect is a possible adverse impact on the functioning of financial intermediation, stemming from downward pressure on financial institutions' profits. The profitability of such institutions had been on a downtrend for many years, due mainly to the declining trend in domestic net interest income (Chart 16). While this had been due in part to the prolonged low interest rate environment, it was also likely to have been caused by intensifying competition among financial institutions, as declines in population and the number of firms in respective regions had limited the demand for funds. Recently, however,

business efficiency has been enhanced, partly owing to the self-help efforts of various financial institutions, and this has sparked a turnaround in the downtrend in profitability. Financial intermediation can be judged as being functioning smoothly, as evidenced by the fact that financial institutions have been maintaining capital bases that are adequate to meet firms' demand for funds, and that the Tankan surveys have shown favorable levels both in terms of lending attitudes among financial institutions and the financial positions of firms (Chart 17).

Another side effect involves productivity. Some suggest that prolonged, large-scale monetary easing has led to continuation of less productive investments and businesses, and furthermore allowed firms that otherwise should have been withdrawn from the market to keep operating, thereby causing delay in economic structural reforms and adversely affecting productivity. It is true that Japan's business entry and exit rates, or its economic metabolic rate, have remained at low levels compared to the United States and Europe (Chart 18). As this is basically a result of each economic entity's actions made based on individual decisions, my view is that large-scale monetary easing cannot necessarily be singled out as the main factor behind such phenomenon. However, I personally believe that it cannot be denied that prolonged, large-scale monetary easing is partly acting to restrain the effects of market principles that should have been at work. Going forward, we must consider what is needed to achieve economic growth that is accompanied by continuous wage increases. Looking first at the microeconomic level, it is important that individual firms continue to enhance their productivity by channeling resources into business fixed investment, research and development, and human capital, as well as through efforts such as reforming their business models. At the macroeconomic level, looking at Japan's economy as a whole, it is important for economic metabolism -- or business entry and exit rates -- to rise, which will lead to a greater proportion of firms with high productivity. Likewise, it is vital that labor mobility be invigorated so that more people will be working in highly productive firms and sectors. Such changes are expected to raise the level of productivity for Japan as a whole.

I have spoken about the side effects of large-scale monetary easing. My view is that it is necessary to examine and assess at some point in future the Bank's conduct of monetary policy, including its monetary policy framework and the price stability target, and then carefully reconsider the balance between positive effects and side effects of monetary policy based on the examination and assessment. At this juncture, however, as I said earlier, I believe that it is appropriate to continue with monetary easing.
Thank you.

11.5. JAPAN MONETARY POLICY JULY 2021

Japan: Bank of Japan holds policy steady at July meeting; fleshes out measures to address climate change At its meeting ending on 16 July, the Bank of Japan (BoJ) kept its monetary policy unchanged, as widely expected by market analysts. In terms of rates, the BoJ left the short-term policy rate for current accounts held by financial institutions at the Bank unchanged at minus 0.10%. It also continued to not set an upper limit on the amount of Japanese government bonds (JGBs) it will purchase in order to cap the 10-year JGB yield at around 0.00%. Regarding asset purchases, the Bank kept its buying commitments unchanged, including those of exchange traded funds, Japanese real estate investment trusts, corporate paper and corporate bonds.
The policy decisions came amid muted price pressures and an ongoing but fragile recovery. The Bank described the economy as still being in a "severe situation" due to the effects of the

Covid-19 pandemic. As such, with a fourth state of emergency likely to constrain economic activity until its proposed end date of 22 August, the BoJ felt that it had grounds to take a wait-and-see approach. Moreover, following the announcement at the June meeting that it will provide funding to financial institutions that are seeking to address issues arising from climate change, the BoJ provided a preliminary outline of the initiatives. These include interest-free loans to banks that boost green and sustainable loans, transition finance and the waiving of negative interest rates on current account balances held at the BoJ. The measures will begin some time this year and run until the end of March 2031 in principle.

Looking ahead, the BoJ reiterated its dovish tone in its communiqué, continuing to state that it will “closely monitor the impact of Covid-19 and will not hesitate to take additional easing measures if necessary”, while it also “expects short- and long-term policy interest rates to remain at their present or lower levels”. Regarding future policy moves, Alvin Liew, senior economist at United Overseas Bank, commented: “July’s policy inaction and the updated inflation outlook did not change our view that the BoJ will not be tightening anytime soon and will maintain its massive stimulus in the next few years, possibly at least until FY 2023. Markets are increasing convinced that the BoJ has reached the end of the line on normalization and will remain in a holding pattern on policy until at least April 2023 when Governor Kuroda is scheduled to leave the BoJ. Attention for the BoJ is now likely shifted to dealing with the long-term climate change issue as the Central Bank starts fleshing out key measures for its green strategy”.

11.6. GREAT MONETARY EXPERIMENT? BOJ'S DECADE OF EASING DRAWS SCRUTINY

TOKYO -- The Bank of Japan's decade of ultraloose monetary policy is raising fresh questions about its merits as architect Gov. Haruhiko Kuroda prepares to hand over the reins, with his predecessor calling it a "great monetary experiment" with "modest" effects. But despite the grumbling, a quick exit from easy money would have its own downside. Kazuo Ueda, the nominee to succeed Kuroda in April, will have to tread a fine line to strike the right balance between minimizing policy side effects and propelling growth.

In the March issue of the International Monetary Fund's quarterly magazine, former BOJ Gov. Masaaki Shirakawa wrote that the Japanese central bank's "great monetary experiment" under Kuroda over the last decade had only "modest" effects on inflation and growth. "Stagnant growth due to structural factors -- notably a rapidly aging and shrinking population -- was misconstrued as cyclical weakness," leading to drawn-out easing, Shirakawa argued. "Monetary policy became a quick fix for structural problems that required more radical reform," he wrote -- and warned that prolonged easing creates "adverse effects on productivity growth through resource misallocation." Shirakawa also criticized other central banks for obsessing over the perils of deflation.

For example, the U.S. Federal reserve decided in 2020 to tolerate higher inflation after watching Japan struggle with falling prices for years. The move stemmed from concern that low inflation expectations would push down interest rates, leaving less room to ease policy during an economic downturn. Shirakawa called this an unfounded fear. Central bankers "confidently contended that inflation was transitory and failed to restrain it even as prices rose rapidly" and were "not entirely blameless," Shirakawa wrote. He urged them to reflect on prevailing monetary policy and design a framework that heeds differences between countries.Other prominent contributors to the magazine also expressed concern about an overreliance on easing.

IMF First Deputy Managing Director Gita Gopinath wrote that "inflation risks from running the economy hot may be much greater than we previously thought." Former Reserve Bank of India Gov. Raghuram Rajan, now a finance professor at the University of Chicago, suggested that quantitative easing has "questionably positive effects on real activity." "Arguably, so long as low inflation does not collapse into a deflationary spiral, central banks should not fret excessively about it," Rajan wrote. "Decades of low inflation are not what slowed Japan's growth and labor productivity. Aging and a shrinking labor force are more to blame." Still, a quick exit from easing would not resolve Japan's economic woes. Stifling recent positive developments, such as an increase in wages, could instead prolong the need for easy policy -- precisely the scenario Shirakawa fears.

Kuroda touted his policy approach at a news conference in late February, describing Japan as no longer in a "deflationary situation" and real economic growth as having recovered. "It is important to support the economy and create an environment where companies can increase wages," he said, and urged continued easing. Ueda also called the current policy "appropriate" in a February parliamentary hearing. But he acknowledged the side effects of BOJ's cap on long-term rates, signaling a willingness to address them. Kuroda's approach has drawn much controversy, including criticism of blurring the line between monetary and fiscal policy. Still, by taking monetary easing to its limit, he helped bring Japan to a place where the debate on spurring growth no longer depends so heavily on monetary policy. As the next BOJ governor, Ueda will be responsible for curbing the side effects of easing and avoiding a premature policy exit, all while steering a comprehensive debate on growth and Japan's fiscal health over the long term.

FOCUS: BOJ chief nominee sticking to familiar playbook, at least for now

Bank of Japan governor nominee Kazuo Ueda speaks at a House of Councillors steering committee meeting in parliament in Tokyo on Feb. 27, 2023. (Kyodo) ==Kyodo

By Noriyuki Suzuki, KYODO NEWS - 19 hours ago - 11:26 | All, Japan, Feature
Bank of Japan governor nominee Kazuo Ueda is signaling that financial markets should not expect big surprises or magical solutions, as he braces for the monumental challenges facing the central bank. His carefully worded statements on monetary policy in his recent confirmation hearings in parliament suggest he will prioritize communication with financial markets and make his thinking behind policy decisions clear.

Ueda, 71, has cast himself as a future BOJ policymaker, who would be realistic, flexible, and also creative in guiding monetary policy after a decade of monetary easing under incumbent Haruhiko Kuroda has exposed its side effects. For now, he said the BOJ's monetary easing is appropriate and should continue as its 2 percent inflation target has yet to be attained in a stable and sustainable way. Still, the academic and former BOJ board member has left hopes alive for a review of the central bank's program to keep borrowing costs low to support the economy, known as "yield curve control." Market participants have taken Prime Minister Fumio Kishida's surprise selection of Ueda as a sign of a gradual departure from the late former premier Shinzo Abe's "Abenomics" economy-booster program that had bold monetary easing as a key pillar. "Mr. Ueda wants to overhaul YCC by looking at (upcoming) economic data, particularly wages, which will certainly become a defining moment," said Hideo Kumano, executive chief economist at Dai-ichi Life Research Institute.

"What matters is how things get off to a start, so April will be key," he added, referring to the BOJ's first meeting to be held under its new governor next month. In response to questions from lawmakers in both houses of parliament, Ueda took the view that the BOJ is still seeking to examine the effect of a December decision to raise the ceiling on 10-year Japanese government bond yields, which stunned financial markets. The move fueled market expectations of further tweaks down the road and a shift to a tighter monetary policy despite the central bank's insistence that it was aimed at fixing market distortions. The market views added upward momentum to 10-year bond yields and the BOJ has had to ramp up bond buying to defend the ceiling as the decision apparently backfired. Bond prices and yields move inversely. Adopted in 2016, YCC sets short-term interest rates at minus 0.1 percent and guides 10-year bond yields around zero percent. Ueda, who will take the helm of the BOJ in April if parliament gives the go-ahead this month, only said he will take time and determine "what it should look like" in consultation with BOJ staff and other board members.

Ueda did not make outright commitments that would limit room for future policy maneuver, largely playing it safe but also giving certain reassurances to both proponents and critics of monetary easing under Kuroda, the BOJ's longest-serving governor. "Mr. Ueda so far fended off pressure from politicians demanding a continuation of reflationary policy. But his statement that he will put the finishing touches to the mission of attaining price stability shows his resolve to eventually begin an exit strategy," Kumano said. Improving economic conditions, especially accelerating inflation in Japan, are also strengthening the view among some market players that a policy change is in the offing.

Japan's key gauge of inflation, the core consumer price index excluding volatile fresh food items, was at a 41-year high of 4.2 percent in January and stayed above the BOJ's 2 percent target for 10 months. If the inflation rate is expected to reach 2 percent, "We will have to normalize powerful monetary steps that are in place. At this point, however, I refrain from explaining what that means, when and how we will normalize them," Ueda said, as he expects the core CPI to fall below the target later this year. Market participants expect 10-year Japanese government bond yields to hit 0.67 percent on average at the end of June, higher than 0.5 percent forecast in March, according to a BOJ survey of financial institutions.

The would-be governor also said that the 2 percent inflation target and a 2013 statement committing the BOJ to attaining the goal as soon as possible should be maintained at least for the time being. Some experts and lawmakers have demanded that they be changed, which would signal a break with the Kuroda era. Hiroshige Seko, a ruling party lawmaker and supporter of Abe's reflationary policy mix, said revising the accord would be like opening

Pandora's box. "How determined are you that you will carry on with Abenomics?" Seko pressed Ueda during a confirmation hearing. Ueda said he is keenly aware of the gravity of the challenge facing the BOJ that does not allow for "wrong judgments" by the next governor, adding he wants to utilize his experience as a board member and academic. Ueda, who taught as a professor at the University of Tokyo, is currently teaching at Tokyo's Kyoritsu Women's University.

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"At the end of the day, how the BOJ wants to remove YCC and communicate it (to financial markets) is important," said Toru Suehiro, chief economist at Daiwa Securities, adding that scrapping YCC will not come before this summer. Economists at Daiwa Institute of Research estimate that doubling the current range of minus 0.5 percent and 0.5 percent for 10-year bond yields will push down real gross domestic product by around 0.2 percent. If YCC is scrapped, GDP will suffer a bigger negative impact of 0.5 percent. Ryutaro Kono, chief Japan economist at BNP Paribas in Japan, said the 10-year yield ceiling could be raised to 1 percent at a policy-setting meeting from Thursday, Kuroda's last. "If Governor Kuroda makes up his mind, it will enable the new leadership under the next chief Ueda to guide monetary policy more smoothly."

11.7. SUMMARY

After studying this lesson student should be able to Know about the . Structure and Commercial banking system. Understand for Economic Activity and Prices. Explain the Role of Japan Monetary Policy July 2021. The Bank of Japan issued its first currency notes in 1885 and, with the exception of a brief period following the Second World War, it has operated continuously ever since. The bank's headquarters in Nihonbashi is located on the site of a historic gold mint, which is located close to the city's Ginza, or "silver mint," district. In 1990, the five largest banks in the world, measured by total assets, were Japanese banks. These banks opened branches abroad, acquired existing foreign banks, and became engaged in new activities, such as underwriting Euro-yen bond issues. The investment houses also increased overseas activities, especially participating in the United States Treasury bond market (where as much as 25 to 30% of each new issue was purchased by Japanese investors in the late 1980s). As of March 1989, the five largest city banks in Japan (in order of total fund volume) were Dai-Ichi Kangyo Bank, Sumitomo Bank, Fuji Bank, Mitsubishi Bank, and Sanwa Bank. The rate of increase in the CPI is expected to decelerate toward the middle of fiscal 2023 due to a waning of the effects of the pass-through of cost increases to consumer prices led by a rise in import prices, as well as to the effects of pushing down energy prices from the of increase of 3 percent for fiscal 2022. The rate of increase is then likely to decelerate to around 1.5-2.0 percent for fiscal 2023 and fiscal 2024 but remain somewhat high compared to the past.

11.8. TECHNICAL TERMS

Structure: A structure is an arrangement and organization of inter related elements in a material object or system, or the object or system so organized. Material structures include man-made objects such as buildings and machines and natural objects such as biological organisms, minerals and chemicals. Abstract structures include data structures in computer science and musical form.

Commercial banking system: Japan's traditional banking system was segmented into clearly defined components in the late 1980s: commercial banks (thirteen major and sixty-four smaller regional banks), long-term credit banks (seven), trust banks (seven), mutual loan and savings banks (sixty-nine), and various specialized financial

Japan Monetary policy: The move sharply contrasted those of Japan's G7 peers, who have either strongly hinted at or already begun to normalize monetary policy. Meanwhile, core inflation continued to increase in March, with the BoJ's forecasts for inflation in FY 2022 increasing by 0.8 percentage points to 1.9%—just below the central bank's 2.0% target.

Economic Activity & Prices: An asset's price should equal the expected discounted value of the asset's payoff (Cochrane, 2009). In general, the main channels through which asset prices affect real economic activity are consumption and investment. The impact on consumption arises via the 'wealth effect', which typically complements the standard income effect.

11.9. SELF ASSESSMENT QUESTIONS

1. Define bank of Japan. Explain the Structure of Bank of Japan.
2. Discuss about Ccommercial banking system of Japan.
3. What do you understand about Economic Activity and Prices?
4. Explain the Role of Japan Monetary Policy July 2021.

11.10. SUGGESTED READINGS

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8. Reviewed by ERIKA RASURE.
9. Fact checked by KIRSTEN ROHRS SCHMITT

Dr. Krishna Banana

LESSON-12
INDUSTRIAL BANKING IN JAPAN

AIMS AND OBJECTIVES

After studying this lesson student should be able to

- Know about the Japan Investment Banks & Minna Bank
- Understand for Top 10 Banks in Japan
- Explain the Role of Industrial Bank of Japan

STRUCTURE

12.1. INTRODUCTION

IBJ was founded as a public-sector bank under the Industrial Bank of Japan Act of 1902. At that time, Japan was in the throes of its industrial revolution, and there was a strong demand for long-term investment capital. IBJ raised funds by issuing bank debentures. Industrial Bank of Japan. The Industrial Bank of Japan, Limited (IBJ), based in Tokyo, Japan, was one of the largest banks in the world during the latter half of the 20th century. It combined with Dai-Ichi Kangyo Bank and Fuji Bank in 2002 to form Mizuho Financial Group. 1 Mitsubishi UFJ Financial Group 2 The Bank of Tokyo-Mitsubishi UFJ 3 Mitsubishi UFJ Trust and Banking Corporation 4 The Senshū Bank 5 The Master Trust Bank of Japan 6 Sumitomo Mitsui Financial Group 7 Sumitomo Mitsui Banking Corporation 8 Mizuho Financial Group 9 Mizuho Bank 10 Mizuho Trust & Banking Co. More items. However, with the advent of technology, Japan has progressed rapidly at the forefront of online banking services. The Bank of Japan (Central Bank) was established in 1882 to control the domestic money supply and act as a “Lender of Last Resort” for the Japanese banks.

This early experience of a sophisticated mix of corporate and investment banking with exposure to trust work is unique to IBJ amongst Japanese banks. In the original Act, there was the wording, “Trust business related to local government bond, corporate bonds, and equities ”.

Industrial Bank of Japan: Type Private Bank- Industry Financial Services- Founded-1902- Successor Merged into Mizuho Financial Group (2001)- Headquarters- 1-3-3 Marunouchi- Key people Masao Nishimura- Products Financial Services- Website- Official website- The Industrial Bank of Japan, Limited (IBJ), based in Tokyo, Japan, was one of the largest banks in the world during the latter half of the 20th century. It combined with Dai-Ichi Kangyo Bank and Fuji Bank in 2002 to form Mizuho Financial Group.[1][2]-

12.2. HISTORY

Former IBJ head office building in Tokyo, currently undergoing demolition- IBJ was founded as a public-sector bank under the Industrial Bank of Japan Act of 1902. At that time, Japan was in the throes of its industrial revolution, and there was a strong demand for long-term investment capital. IBJ raised funds by issuing bank debentures. IBJ also acted as the trustee in corporate debenture issues - notably, the major Japanese railway company issue of 1906 in London, amount to the then-enormous sum of 1 million pounds sterling. These activities contributed to the building of the Japanese domestic securities market, and to the generating of a higher profile for Japanese borrowers in the international market. This early experience of a sophisticated mix of corporate and investment banking with exposure to trust work is unique to IBJ amongst Japanese banks. In the original Act, there was the wording, “Trust business related to local government bond, corporate bonds, and equities”. This was the first time for the term “trust”, or “shintaku” (信託), to appear in the Japanese statute book.

The 1918 amendment to the IBJ Act permitted the underwriting and offering of equities. At that point, IBJ had the full capabilities for what is now termed investment banking. However, that was at what proved to be the peak of the demand created for Japanese products by the First World War and the consequent economic boom. Thereafter, the next 30 years of Japanese history encompassed many adversities for society in general and for financial institutions in particular: the Great Kantō earthquake, the Showa Financial Panic, and finally, the Second World War and the postwar recovery. IBJ became a private-sector bank in 1950 and took on legal form under the Long-Term Bank Act of 1952.

However, the Act was framed within the terms of the US-led Occupation policy of compartmentalizing financial services. IBJ was forced to retreat from much of its former investment banking activities and return principally to long-term lending funding by issuing bank debentures. During the high-growth period of the Japanese economy in the 1960s, IBJ was particularly active in financing steel production, shipping, shipbuilding, and automobile manufacturing. Following the first oil crisis, Japan moved to a pattern of lower growth as a mature economy, and IBJ expanded its customer base at home, and started the process of expansion overseas. In Japan, the wholesaling of bank debentures to major financial institutions and the regional banks led to a network of strong relationships. This was all supported by the fact that, originally a public-sector bank, IBJ had no keiretsu affiliations: IBJ has always been independent of the large corporate groupings characteristic of Japan and was hence number 2 banker to each and all of the major keiretsu groupings. Internationally, IBJ was free to pursue its investment-banking-ambitions.

12.3. JAPAN INVESTMENT BANKS

Banking system in Japan: The Japanese banking system is stable and well regulated. There are approximately 195 banks operating in Japan including 54 foreign financial institutions.

The big three banks in Japan are Mitsubishi UFJ Financial Group, SMBC Group and Mizuho Financial Group. The Bank of Japan, founded in 1882, is the central bank of the country.

Japan Investment Banks: Mizuho Financial Group Global Investment Bank (Japan focused), Nomura Holdings Global Investment Bank (Japan focused), Sumitomo Mitsui Financial Group Global Investment Bank (Japan focused), Mitsubishi UFJ Financial Group Japan Investment Bank – Boutique

The best investment banks in Japan: Shipping industry proposes levy to speed up zero carbon future Trading List Of Investment Banks In Japan Capital & Credit Merchant Bank Citibank First Caribbean International Bank First Global Bank HSBC Bank JP Morgan Bank MF&G Trust & Finance National Commercial of Jamaica NCB Jamaica Ltd PanCaribbean Merchant Bank. Can a foreign bank conduct banking business in Japan? A foreign bank cannot conduct banking business in Japan on the basis of its home state banking licence. However, a foreign bank can obtain a licence from the Prime Minister by establishing a branch office in Japan (paragraph 1, Article 47, Banking Act) (see Question 4, Foreign Applicants). Are securities firms regulated in Japan? It is securities firms (rather than banks) that mainly engage in investment banking business in Japan. This chapter discusses banks regulated by the Banking Act and, unless specifically mentioned, does not cover the regulation of securities firms.

12.4. MINNA BANK: JAPAN'S FIRST DIGITAL BANK

Japan’s digital native consumers don't need a brick-and-mortar banking experience, so Minna Bank built a different bank for them—in the cloud. First came the digital natives. Then, the financial technology companies flexed their muscles. Next, we saw a variety of non-banking companies entering the banking field. With all of these rule changes and paradigm shifts affecting banking on a global level, Bank of Fukuoka, the core bank of the Fukuoka Financial Group (FFG), based in Kyushu, Japan, knew they needed to transform. “The number of customers visiting traditional branches of the FFG decreased by 40% over the past 10 years, while the number of customers using internet banking increased by 2.4 times over the same period,” said Koji Yokota, President, Minna Bank. To create a bank for everyone—including digital natives—FFG would have to change. But how?

FFG began by establishing iBank Marketing Corporation, a platform company to explore potential business models for the bank of the future by connecting the financial and non-financial sectors with local communities. Kenichi Nagayoshi, the founder of iBank Marketing and Director and Vice President of Minna Bank, explained: "Our mission was to create innovative financial services, which is why we launched iBank Marketing to develop simple financial functions and digital marketing, with data and analytics at its core. Our core product app, Wallet+, has been downloaded more than 1.6 million times. We thought it was time to create a new platform for financial services now that the game is changing."

"We chose Accenture as our partner largely because of their global digital expertise in technology, in design, and in data analytics. This, combined with their ability to execute, enabled us to launch our service on time, even in the midst of the COVID-19 pandemic. Accenture is an excellent company and our best partner." — KOJI YOKOTA, President – Minna Bank- Minna Bank has won the "Brand of the Year" award in the brand category of the Red Dot Design Award 2021, one of the world's three major design awards. They are the first Japanese company to win this award, and the first financial institution in the world to win it. The company also won "Best of the Best" (the highest award of the year) in the Communication Design category (Applications) and "Red Dot" in the Communication Design category (Brand Design & Identity), winning three awards simultaneously. Koji Yokota, President, Minna Bank

When tech meets human ingenuity:
Under these circumstances, FFG is implementing a "two-way approach" in digital transformation. While FFG, which has a traditional bank, is steadily implementing digital transformation, the approach is to establish Japan's first digital bank, Minna Bank, as an organization to implement digital transformation in a single step without the constraints of the existing business. This bank was the first bank in the world to build a full cloud banking system, and the system was built in the midst of a pandemic, with overwhelming speed. Minna Bank was designed as a digital technology company that provides financial services to digital native customers. “We looked all over the world for a suitable platform for a digital bank, but there was no banking system built in the public cloud. So we decided to create a full cloud bank ourselves,“ said Nagayoshi.

Accenture is providing support in the adoption of Agile development and in multiple areas such as automation, strategy and talent development. Its Banking, Strategy & Consulting, Technology, and Interactive teams have come together from Fukuoka, Osaka, Tokyo, Aizu, Hokkaido and two overseas locations, transcending national and organizational boundaries to partner with Minna Bank. In addition to its own resources, Accenture has drawn on its vast ecosystem of technology partners—in this case, industry leaders such as Google, Microsoft, AWS, Salesforce and Oracle—to take advantage of their solutions and best practices.

Specifically, in the "Zero Bank Core Solution" jointly developed by Minna Bank and Accenture, the core system will be implemented on Google Cloud using Accenture's Digital Experience and cloud-first approach, connected technology and cloud-native core solution. For contact center operations, Amazon Web Services (AWS), Amazon Connect and Salesforce's Service Cloud have been combined. Microsoft's Azure is being used for the virtual desktop infrastructure for employee and system operations, and Oracle Cloud is being used for the accounting system. Collaboration with these solution providers has allowed Minna Bank to build its foundation as a cloud-first business with the latest technology available worldwide.

In 2020, in the midst of the COVID-19 pandemic, the Minna Bank project team continued to press forward. It took no more than 18 months to invent and launch a transformational bank in a country with strict regulations governing financial institutions—an unprecedented achievement. "If it wasn't for cloud, we would have been six months late in opening. Cloud's scalability, speed of deployment and efficiency in fixing bugs are the reasons for the agility of our banking services," said Yokota. Kenichi Nagayoshi, Deputy President & COO, Minna Bank

A valuable difference: Minna Bank differs from traditional banks not only by virtue of its operating model, but also its marketing and promotion. Instead of using mass media, it actively employs social media and develops promotions by observing mentions among users. This approach is made possible by a user interface and experience that perfectly matches the preferences of the bank’s target market. To target digital natives, Accenture's team of designers pursued a simple and appealing graphical presentation with minimal descriptive information.

The planning and design process started with a thorough understanding of the thinking and behavior of digital natives, and a commitment to develop services from the customer's perspective: when and how do they want to use financial services? This approach enabled Minna Bank to become a frictionless app that people want to use every day. It is also a portal for non-financial services, providing great value to customers by turning data-based marketing into a service. "We are the first bank in Japan to truly integrate financial and non-financial data into a single service," said Nagayoshi.

Minna Bank has three core business concepts: Give shape to everyone's voice—provide new financial services in line with changes in customer behavior. Deliver the best for everyone—become a comprehensive financial concierge based on an understanding of customers. Integrate into people's daily lives—realize the concept of a BaaS (Banking as a Service) business. BaaS is a new banking system offering based on the Accenture Cloud Native Core Solution. It helps business partners to create new value in the banking industry. Minna Bank, a unique digital entity, is a bank for the age of a data-driven society. It will continue to be a bank that explores the potential of hyper-personalization and makes customers say "Wow!" "As Japan's first digital bank, Minna Bank will be the epicenter of innovation in the Japanese financial industry. Accenture is committed to continuing to be an engine of innovation for Minna Bank," said Masashi Nakano, Senior Managing Director, Financial Services, Accenture.

12.5. BANKS IN JAPAN

Overview of Banks in Japan: The banks in Japan operate similarly to institutions worldwide, offering regular financial services. However, with the advent of technology, Japan has progressed rapidly at the forefront of online banking services. The Bank of Japan (Central Bank) was established in 1882 to control the domestic money supply and act as a “Lender of Last Resort” for the Japanese banks. Currently, the financial system in Japan is going through a negative interest rate regime whereby depositors have to save their money, and lenders are paid for borrowing money.

12.5.1. List of Top 10 Banks In Japan

Mitsubishi UFJ Financial Group-Japan Post Bank Co., Ltd.-Mizuho Financial Group-Sumitomo Mitsui Financial Group-Norinchukin Bank-Resona Holdings- Fukuoka Financial Group-Chiba Bank-Bank of Yokohama/Concordia Financial Group-Hokuhoku Financial Group, Inc.-Let us explain each one of them in detail: –- Top-Banks-in-Japan- You are free to use this image on your website, templates, etc., Please provide us with an attribution link

1. Mitsubishi UFJ Financial Group-One of the leading companies of the Mitsubishi Group, this bank is Japan’s largest financial group and the world’s second-largest Bank Holding company. It is the second-largest firm in Japan regarding market capitalization-, with its headquarters in Chiyoda, Tokyo. In addition, it functions in various businesses, such as retail banking, corporate banking, and trust assets in around 50 countries. The net operating profits-for 1Q17 were ¥349.0.

2. Japan Post Bank Co., Ltd.: Established in 2006 and headquartered in Tokyo. It is primarily a savings institution and was a part of the reorganization of Japan Post into Japan Post Holdings, which permits the wiring of funds between the post office and the banking unit. The loan facilities include the overdraft- services secured by Japanese government bonds- and time-bound deposits. It is one of Japan's largest deposit banks and offers nationwide services of funds withdrawal with international debit- and credit cards. The banks' total assets were ¥205 trillion, with a total income of ¥266 billion as of 2019.

3. Mizuho Financial Group: Mizuho Financial Group is a public sector bank holding company with its headquarters in the Otemachi district of Chiyoda in Tokyo. Established in 2003, this group offers various banking services around the globe, such as:Business and Retail Banking-Corporate and Institutional Company-Global Corporate Banking-Asset management services-Markets and Securities-Norinchukin Bank-Resona Holdings-The bank employed around 59,132 employees as of 2020 and had a net income of ¥603.54 billion as of 2017.

4. Sumitomo Mitsui Financial Group: It is a Japanese bank holding/ financial services company established in 2002 in Chiyoda, Tokyo. It holds assets worth $2.036 trillion around the world, offering services such as: –Personal Banking-Corporate Banking-Investment Banking/Management-Wealth Management-Credit Cards-For 2019, it reported total assets- of $2.036 trillion and a total income of $6.47 billion. In addition, it has several subsidiaries offering professional services for respective financial products.

5. Norinchukin Bank: It was founded in 1923 by the Japanese government to support its agricultural prospects. It played a crucial role in rebuilding post World War II, especially with investments- in the textile industry. In addition, it is one of the largest institutional investors with an investment portfolio of over $400 billion and over $850 billion in assets. Norinchukin Bank is well known as Japan's largest hedge- fund, with branches in New York, London, and Singapore.-The bank invests in bonds, securitization facilities, private stock equity, real estate, forest, and fisheries. As of 2016, the bank's total assets were $1,000 billion and a total income of $19 million.

6. Resona Holdings: It is the holding company- of the Resona Group (5th largest banking group) with its headquarters in Koto, Tokyo. The primary operating entities of the group are: – Resona Bank (corporate and retail bank)-Saitama Resona Bank-The focus of the groups is to offer professional services in the following segments: Individual Segment – Consultation relating to personal loans- and asset management/restructuring.-Corporate Segment – Loans for corporate, asset management-, real estate, corporate pension, business succession, and other supporting activities to grow a business.arket Segment – Responsible for procurement and operation of funds, FOREX, bonds, and derivative facilities. For Q1 '17, the net income- attributable to shareholders- is ¥37.2 billion and employs around 70,000 employees.

7. Fukuoka Financial Group: Fukuoka Financial Group is a Japanese company listed on the Nikkei, established as a financial holding with the holding of the Shinwa Bank as a wholly-owned subsidiary-. Its headquarters is in Fukuoka (the largest city of Kyushu, located in the south of Japan). The group's primary services are banking, which constitutes deposits, loans, and domestic and foreign exchange- services. Other services include guarantees, revitalization support, loans management, and collection business. In 2016, the total income of the bank was $2 billion.

8. Chiba Bank: This bank is the third largest of Japan's 64 regional banks in total assets. It has headquarters in Chiba (adjacent to Tokyo) and has one of Japan's most important industrial concentrations. The bank's strategy is to expand its branch network into adjacent areas along Tokyo-bound railway lines. Emphasis is also on the development of southern

Chiba Prefecture as a tourist and resort area. One of the few institutions disclosing NIM (Net Interest Margins-) on their lending facilities.

9. Bank of Yokohama/Concordia Financial Group: It is the largest regional bank of Japan operating in southwestern Tokyo. It was formed amidst the collapse of several existing banks in the region to smoothen the financial services in the area. In 2015, the Bank of Yokohama announced a merger with Higashi-Nippon Bank to create Concordia Financial Group, Ltd. As a result, it was listed on the Nikkei 225 stock market index.

10. Hokuhoku Financial Group: It was established in 2003 with its headquarters in Toyama. The following segments are operated in this group:–Hokuriku Bank-Hokkaido Bank- Other segments-The banking segments offer financial services through banking operations. The other component handles the leasing and credit card business and non-banking subsidiaries. The Hokuriku Bank and the Hokkaido Bank underwent management integration in 2004 to form the Hokuhoku Financial Group, Inc., which today operates as a super-regional financial network enclosing the entire Hokuriko region (Tokyo, Osaka, and Nagoya areas).

12.6. INDUSTRIAL BANK OF JAPAN

Japanese bank-Alternate titles: Nippon Kōgyō Ginkō: Industrial Bank of Japan, Japanese Nippon Kōgyō Ginkō, former Japanese commercial bank that operated a general-banking and foreign-exchange business with branches in Japan and overseas. Established in 1902, the bank had specialized in medium- and long-term financing of industrial development, and both its main office and its foreign branches were active in the foreign-exchange markets. In September 2000, Industrial Bank of Japan merged with the Dai-Ichi Kangyō Bank and Fuji Bank to form the Mizuho Financial Group.

Mizuho Financial Group, Inc: Introduction-Fast Facts-Facts & Related Content: Mizuho Financial Group, Inc., Japanese bank holding company, one of the largest in the world in terms of assets, which exceeded $1 billion when it was founded. Mizuho originated in September 2000 with the mergers of Dai-Ichi Kangyō Bank, Fuji Bank, and the Industrial Bank of Japan. Losses at Mizuho and other Japanese banks, stemming largely from loan write-offs, were criticized as contributing to weakness in Japan’s economy at the start of the 21st century.

Commercial bank, bank with the power to make loans that, at least in part, eventually become new demand deposits. Because a commercial bank is required to hold only a fraction of its deposits as reserves, it can use some of the money on deposit to extend loans. When a borrower receives a loan, his checking account is credited with the amount of the loan; total demand deposits are thus increased until the loan is repaid. As a group, then, commercial banks are able to expand or contract the money supply by creating new demand deposits.

The name commercial bank was first used to indicate that the loans extended were short-term loans to businesses, though loans later were extended to consumers, governments, and other nonbusiness institutions as well. In general, the assets of commercial banks tend to be more liquid and carry less risk than the assets held by other financial intermediaries. Most commercial banks offer a variety of services to their customers, including savings deposits, safe-deposit boxes, and trust services.

Principles of banking: The central practice of banking consists of borrowing and lending. As in other businesses, operations must be based on capital, but banks employ comparatively little of their own capital in relation to the total volume of their transactions. Instead banks use the funds obtained through deposits and, as a precaution, maintain capital and reserve accounts to protect against losses on their loans and investments and to provide for unanticipated cash withdrawals. Genuine banks are distinguished from other kinds of financial intermediaries by the readily transferable or "spendable" nature of at least some of their liabilities (also known as IOUs), which allows those liabilities to serve as means of exchange—that is, as money.

Types of banks: The principal types of banks in the modern industrial world are commercial banks, which are typically private-sector profit-oriented firms, and central banks, which are public-sector institutions. Commercial banks accept deposits from the general public and make various kinds of loans (including commercial, consumer, and real-estate loans) to individuals and businesses and, in some instances, to governments. Central banks, in contrast, deal mainly with their sponsoring national governments, with commercial banks, and with each other. Besides accepting deposits from and extending credit to these clients, central banks also issue paper currency and are responsible for regulating commercial banks and national money stocks.

Britannica Money Britannica Money- Bull and Bear Markets: What to Know About Each
The term commercial bank covers institutions ranging from small neighbourhood banks to huge metropolitan institutions or multinational organizations with hundreds of branches. Although U.S. banking regulations limited the development of nationwide bank chains through most of the 20th century, legislation in 1994 easing these limitations led American commercial banks to organize along the lines of their European counterparts, which typically operated offices and bank branches in many regions.

Subscribe Now: While these and other institutions are often called banks, they do not perform all the banking functions described above and are best classified as financial intermediaries. Institutions that fall into this category include finance companies, savings banks, investment banks (which deal primarily with large business clients and are mainly concerned with underwriting and distributing new issues of corporate bonds and equity shares), trust companies, finance companies (which specialize in making risky loans and do not accept deposits), insurance companies, mutual fund companies, and home-loan banks or savings and loan associations. One particular type of commercial bank, the merchant bank (known as an investment bank in the United States), engages in investment banking activities such as advising on mergers and acquisitions. In some countries, including Germany, Switzerland, France, and Italy, so-called universal banks supply both traditional (or "narrow") commercial banking services and various nonbank financial services such as securities underwriting and insurance. Elsewhere, regulations, long-established custom, or a combination of both have limited the extent to which commercial banks have taken part in the provision of nonbank financial services.

Bank money: The development of trade and commerce drove the need for readily exchangeable forms of money. The concept of bank money originated with the Amsterdamsche Wisselbank (the Bank of Amsterdam), which was established in 1609 during Amsterdam's ascent as the largest and most prosperous city in Europe. As an exchange bank, it permitted individuals to bring money or bullion for deposit and to withdraw the money or the worth of the bullion. The original ordinance that established the bank further required that all bills of 600 gulden or upward should be paid through the bank—in other words, by the transfer of deposits or credits at the bank. These transfers later came to be known as “bank money.” The charge for making the transfers represented the bank’s sole source of income.

Bank loans: Bank loans, which are available to businesses of all types and sizes, represent one of the most important sources of commercial funding throughout the industrialized world. Key sources of funding for corporations include loans, stock and bond issues, and income. In the United States, for example, the funding that business enterprises obtain from banks is roughly twice the amount they receive by marketing their own bonds, and funding from bank loans is far greater still than what companies acquire by issuing shares of stock. In Germany and Japan bank loans represent an even larger share of total business funding. Smaller and more specialized sources of funding include venture capital firms and hedge funds.

Historical development-Early banking: Some authorities, relying upon a broad definition of banking that equates it with any sort of intermediation activity, trace banking as far back as ancient Mesopotamia, where temples, royal palaces, and some private houses served as storage facilities for valuable commodities such as grain, the ownership of which could be transferred by means of written receipts. There are records of loans by the temples of Babylon as early as 2000 BCE; temples were considered especially safe depositories because, as they were sacred places watched over by gods, their contents were believed to be protected from theft. Companies of traders in ancient times provided banking services that were connected with the buying and selling of goods. The earliest genuine European banks, in contrast, dealt neither in goods nor in bills of exchange but in gold and silver coins and bullion, and they emerged in response to the risks involved in storing and transporting precious metal moneys and, often, in response to the deplorable quality of available coins, which created a demand for more reliable and uniform substitutes.

In continental Europe dealers in foreign coin, or “money changers,” were among the first to offer basic banking services, while in London money “scriveners” and goldsmiths played a similar role. Money scriveners were notaries who found themselves well positioned for bringing borrowers and lenders together, while goldsmiths began their transition to banking by keeping money and valuables in safe custody for their customers. Goldsmiths also dealt in bullion and foreign exchange, acquiring and sorting coin for profit. As a means of attracting coin for sorting, they were prepared to pay a rate of interest, and it was largely in this way that they eventually began to outcompete money scriveners as deposit bankers.

Specialization: Banks in Europe from the 16th century onward could be divided into two classes: exchange banks and banks of deposit. The last were banks that, besides receiving deposits, made loans and thus associated themselves with the trade and industries of a country. The exchange banks included in former years institutions such as the Bank of Hamburg and the Bank of Amsterdam. These were established to deal with foreign exchange and to facilitate trade with other countries. The others—founded at very different dates—were established as, or early became, banks of deposit, such as the Bank of England, the Bank of Venice, the Bank of Sweden, the Bank of France, the Bank of Germany, and others. Important as exchange banks were in their day, the period of their activity had generally passed by the last half of the 19th century.

The development of banknotes: Although the Bank of England is usually credited with being the source of the Western world’s first widely circulated banknotes, the Stockholms

Banco (Bank of Stockholm, founded in 1656 and the predecessor of the contemporary Bank of Sweden) is known to have issued banknotes several decades before the Bank of England's establishment in 1694, and some authorities claim that notes issued by the Casa di San Giorgio (Bank of Genoa, established in 1407), although payable only to specific persons, were made to circulate by means of repeated endorsements. In Asia paper money has a still longer history, its first documented use having been in China during the 9th century, when "flying money," a sort of draft or bill of exchange developed by merchants, was gradually transformed into government-issued fiat money. The 12th-century Tatar war caused the government to abuse this new financial instrument, and China thereby earned credit not merely for the world's first paper money but also for the world's first known episode of hyperinflation. Several more such episodes caused the Chinese government to cease issuing paper currency, leaving the matter to private bankers. By the late 19th century, China had developed a unique and, according to many accounts, successful bank money system, consisting of paper notes issued by unregulated local banks and redeemable in copper coin. Yet the system was undermined in the early 20th century, first by demands made by the government upon the banks and ultimately by the decision to centralize and nationalize China's paper currency system.

Commercial banks- Operations and management:

The essential business of banking involves granting bank deposit credits or issuing IOUs in exchange for deposits (which are claims to base money, such as coins or fiat paper money); banks then use the base money—or that part of it not needed as cash reserves—to purchase other IOUs with the goal of earning a profit on that investment. The business may be most readily understood by considering the elements of a simplified bank balance sheet, where a bank's available resources—its "assets"—are reckoned alongside its obligations, or "liabilities."

Assets: Bank assets consist mainly of various kinds of loans and marketable securities and of reserves of base money, which may be held either as actual central bank notes and coins or in the form of a credit (deposit) balance at the central bank. The bank's main liabilities are its capital (including cash reserves and, often, subordinated debt) and deposits. The latter may be from domestic or foreign sources (corporations and firms, private individuals, other banks, and even governments). They may be repayable on demand (sight deposits or current accounts) or after a period of time (time, term, or fixed deposits and, occasionally, savings deposits). The bank's assets include cash; investments or securities; loans and advances made to customers of all kinds, though primarily to corporations (including term loans and mortgages); and, finally, the bank's premises, furniture, and fittings.

Great Depression: soup kitchen- More From Britannica: Great Depression: Banking panics and monetary contraction: Unless a bank held cash equivalent to 100 percent of its demand deposits, it could not meet the claims of depositors were they all to exercise in full and at the same time their right to demand cash. If that were a common phenomenon, deposit banking could not survive. For the most part, however, the public is prepared to leave its surplus funds on deposit with banks, confident that money will be available when needed. But there may be times when unexpected demands for cash exceed what might reasonably have been anticipated; therefore, a bank must not only hold part of its assets in cash but also must keep a proportion of the remainder in assets that can be quickly converted into cash without significant loss.

Asset management: A bank may mobilize its assets in several ways. It may demand repayment of loans, immediately or at short notice; it may sell securities; or it may borrow from the central bank, using paper representing investments or loans as security. Banks do not precipitately call in loans or sell marketable assets, because this would disrupt the delicate debtor-creditor relationship and lessen confidence, which probably would result in a run on the banks. Banks therefore maintain cash reserves and other liquid assets at a certain level or have access to a “lender of last resort,” such as a central bank. In a number of countries, commercial banks have at times been required to maintain a minimum liquid assets ratio. Among the assets of commercial banks, investments are less liquid than money-market assets. By maintaining an appropriate spread of maturities (through a combination of long-term and short-term investments), however, it is possible to ensure that a proportion of a bank’s investments will regularly approach redemption. This produces a steady flow of liquidity and thereby constitutes a secondary liquid assets reserve.

Liability and risk management: The traditional asset-management approach to banking is based on the assumption that a bank’s liabilities are both relatively stable and unmarketable. Historically, each bank relied on a market for its deposit IOUs that was influenced by the bank’s location, meaning that any changes in the extent of the market (and hence in the total amount of resources available to fund the bank’s loans and investments) were beyond a bank’s immediate control. In the 1960s and ’70s, however, this assumption was abandoned. The change occurred first in the United States, where rising interest rates, together with regulations limiting the interest rates banks could pay, made it increasingly difficult for banks to attract and maintain deposits. Consequently, bankers devised a variety of alternative devices for acquiring funds, including repurchase agreements, which involve the selling of securities on the condition that buyers agree to repurchase them at a stated date in the future, and negotiable certificates of deposit (CDs), which can be traded in a secondary market. Having discovered new ways to acquire funds, banks no longer waited for funds to arrive through the normal course of business. The new approaches enabled banks to manage the liability as well as the asset side of their balance sheets. Such active purchasing and selling of funds by banks, known as liability management, allows bankers to exploit profitable lending opportunities without being limited by a lack of funds for loans. Once liability management became an established practice in the United States, it quickly spread to Canada and the United Kingdom and eventually to banking systems worldwide.

The role of bank capital: Because even the best risk-management techniques cannot guarantee against losses, banks cannot rely on deposits alone to fund their investments. Funding also comes from share owners’ equity, which means that bank managers must concern themselves with the value of the bank’s equity capital as well as the composition of the bank’s assets and liabilities. A bank’s shareholders, however, are residual claimants, meaning that they may share in the bank’s profits but are also the first to bear any losses stemming from bad loans or failed investments. When the value of a bank’s assets declines, shareholders bear the loss, at least up to the point at which their shares become worthless, while depositors stand to suffer only if losses mount high enough to exhaust the bank’s equity, rendering the bank insolvent. In that case, the bank may be closed and its assets liquidated, with depositors (and, after them, if anything remains, other creditors) receiving prorated shares of the proceeds. Where bank deposits are not insured or otherwise guaranteed by government authorities, bank equity capital serves as depositors’ principal source of security against bank losses.

Deposit insurance-Rationale for deposit insurance: Most countries require banks to participate in a federal insurance program intended to protect bank deposit holders from losses that could occur in the event of a bank failure. Although bank deposit insurance is primarily viewed as a means of protecting individual (and especially small) bank depositors, its more subtle purpose is one of protecting entire national banking and payments systems by preventing costly bank runs and panics.

In a theoretical scenario, adverse news or rumours concerning an individual bank or small group of banks could prompt holders of uninsured deposits to withdraw all their holdings. This immediately affects the banks directly concerned, but large-scale withdrawals may prompt a run on other banks as well, especially when depositors lack information on the soundness of their own bank's investments. This can lead them to withdraw money from healthy banks merely through a suspicion that their banks might be as troubled as the ones that are failing. Bank runs can thereby spread by contagion and, in the worst-case scenario, generate a banking panic, with depositors converting all of their deposits into cash. Furthermore, because the actual cash reserves held by any bank amount to only a fraction of its immediately withdrawable (e.g., "demand" or "sight") deposits, a generalized banking panic will ultimately result not only in massive depositor losses but also in the wholesale collapse of the banking system, with all the disruption of payments and credit flows any such collapse must entail.

How deposit insurance works: Deposit insurance eliminates or reduces depositors' incentive to stage bank runs. In the simplest scenario, where deposits (or deposits up to a certain value) are fully insured, all or most deposit holders enjoy full protection of their deposits, including any promised interest payments, even if their bank does fail. Banks that become insolvent for reasons unrelated to panic might be quietly sold to healthy banks, immediately closed and liquidated, or (temporarily) taken over by the insuring agency.

Origins of deposit insurance: Although various U.S. state governments experimented with deposit insurance prior to the establishment of the FDIC in 1933, most of these experiments failed (in some cases because the banks engaged in excessive risk taking). The concept of national deposit insurance had garnered little support until large numbers of bank failures during the first years of the Great Depression revived public interest in banking reform. In an era of bank failures, voters increasingly favoured deposit insurance as an essential protection against losses. Strong opposition to nationwide branch banking (which would have eliminated small and underdiversified banks through a substantial consolidation of the banking industry), combined with opposition from unit banks (banks that lacked branch networks), prevailed against larger banks and the Roosevelt administration, which supported nationwide branch banking; this resulted in the inclusion of federal deposit insurance as a component of the Banking Act of 1933. Originally the law provided coverage for individual deposits up to $5,000. The limit was increased on several occasions since that time, reaching $250,000 for interest-bearing accounts in 2010. Deposit insurance has become common in banking systems worldwide. The particulars of these schemes can differ substantially; some countries require coverage that amounts to only a few hundred U.S. dollars, while others offer blanket guarantees that cover nearly 100 percent of deposited moneys. In 1994 a uniform deposit-insurance scheme became a component of the European Union's single banking market.

12.7. SUMMARY

Overview of Banks in Japan- Structure of Banks in Japan- List of Top 10 Banks in Japan-#1. Mitsubishi UFJ Financial Group-#2. Japan Post Bank Co., Ltd.:-#3. Mizuho Financial Group:-#4. Sumitomo Mitsui Financial Group:-#5. Norinchukin Bank:-#6. Resona Holdings:-#7. Fukuoka Financial Group:-#8. Chiba Bank:-#9. Bank of Yokohama/Concordia Financial Group:-#10. Hokuhoku Financial Group-Recommended Articles-Structure of Banks in Japan-The banking system of Japan is classified into: -Foreign banks-Domestically licensed banks include regional, city, and trust banks- The traditional banks in Japan were divided into clearly defined segments: -Commercial banks-Long-term credit banks-Trust banks (retail banking activities)-Loans and savings bank-During the 1980s, non-banking operations (consumer loans-, credit cards) had also cropped up. Then such organizations also started offering traditional functions of banks (e.g., issuing of loans). Subsequently, in 1990, the five largest banks were Japanese banks in total assets. Moreover, such banks opened branches across the globe, traded in FOREX activities, and flourished the position of the Japanese banking system on the world map. Most countries insure bank deposits up to a certain amount, with few offering blanket deposit coverage (i.e., 100 percent of the amount any depositor holds with a bank). In the United States, blanket deposit coverage was established for non-interest-bearing transaction accounts (which allow an unlimited number of withdrawals and transfers) by the Dodd-Frank Wall Street Reform and Consumer Protection Act (2010).

12.8. TECHNICAL TERMS

Commercial banks: The term “commercial bank” refers to a financial institution that accepts deposits, offers checking account services, makes various loans, and offers basic financial products like certificates of deposit (CDs) and savings accounts to individuals and small businesses.

Foreign banks: A foreign bank branch is a type of foreign bank that is obligated to follow the regulat…A foreign bank branch is a type of foreign bank that is obligated to follow the re…Banks often open a foreign branch to provide more services to their multinational c…Foreign bank branches tend to be more effective in countries with high.

Trust banks: A trust bank is a bank that helps in transferring assets among customers through the means of formal contracts known as trust. The customer who transfers their assets is termed the settler. The customer who accepts the settler’s assets is termed as the beneficiary. The role of the trustee is to monitor and administer

Licensed banks: Since April 2014, the Reserve Bank of India (RBI) has granted 23 banking licences to new players - two were given universal banking licences (April 2, 2014), 11 were issued payments banks licences (August 19, 2015) and 10 were given licences for small finance banks (September 16, 2015). The niche banks – small finance and payments banks -have been set up to further the regulator's objective of deepening financial inclusion. Going ahead, RBI is planning to come up with "on tap" licences which means there will not be any cut-off date for applying for the licences.

I.B. of Japan: The In-dus-trial Bank of Japan, Lim-ited (IBJ), based in Tokyo, Japan, was one of the largest banks in the world dur-ing the lat-ter half of the

20th cen-tury. It com-bined with Dai-Ichi Kangyo Bank and Fuji Bank in 2002 to form Mizuho Fi-nan-cial Group.

12.9. SELF ASSESSMENT QUESTIONS

1. Evolution and History of Commercial banks in Japan-Explain
2. Discuss various Japan Investment Banks .
3. Explain Minna Bank which is the Japan's First Digital Bank
4. Discuss about Top 10 Banks in Japan
5. What is the role of Industrial Bank of Japan

12.10. SUGGESTED READINGS

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5. Reviewed by ERIKA RASURE.
6. Fact checked by KIRSTEN ROHRS SCHMITT

Dr. Krishna Banana

LESSON-13
INDIAN BANKING SYSTEM

AIMS AND OBJECTIVES

After studying this lesson, you should be able to:

- Know the meaning of Private Banking
- Understand Advantages and disadvantages of Private Banking.
- Study Top 10 Best Private Sector Banks in India 2023

STRUCTURE

13.1. INTRODUCTION

The organised banking system in India can be classified as given below: Reserve Bank of India (RBI): The country had no central bank prior to the establishment of the RBI. The RBI is the supreme monetary and banking authority in the country and controls the banking system in India. The Reserve Bank of India (RBI), commercial banks, cooperative banks, and specialized financial entities (ICICI, IFC, IDBI Bank, etc.) belong to the organized sector. Let's study more about the types of banks in India along with the examples in the following sections. The RBI or the Reserve Bank of India is the central bank of India. Banking in India, in the modern sense, originated in the last decade of the 18th century. Among the first banks were the Bank of Hindustan, which was established in 1770 and liquidated in 1829–32; and the General Bank of India, established in 1786 but failed in 1791. The scheduled banks are those included under the 2nd Schedule of the Reserve Bank of India Act, 1934. The scheduled banks are further classified into: nationalised banks; State Bank of India and its associates; Regional Rural Banks (RRBs); foreign banks; and other Indian private sector banks.

13.2. LIST OF ALL PUBLIC AND PRIVATE SECTOR BANKS IN INDIA 2022

With the merger of banks in 2019, there are a total of 12 public sector banks and 21 private sector banks in India. Check the list of Public Sector Banks and Private Sector Banks in India

2022. List of all Public and Private Sector Banks in India 2022: The Reserve Bank of India (RBI) is the highest banking regulatory authority in India which was established by the RBI Act, 1934. The banks in India are divided into two categories-- scheduled banks and non-scheduled banks. Scheduled banks are those banks that are included in the second schedule of the RBI Act, 1934, while the non-scheduled banks are not listed in the second schedule of the RBI Act, 1934. On the basis of ownership, the banks are further divided into-- Private Sector Banks, Public Sector Banks, and Foreign Banks. Types of commercial banks in India: Scheduled Banks:- Banks that have been included in the Second Schedule of RBI Act,1934. These are categorized below.

1. **Private Sector Banks:-** Majority of the stake is held by private individuals. Examples of Private banks are HDFC Bank, ICICI Bank, AXIS Bank, etc.

2**. Public Sector Banks:-** Majority of the stake is held by the government. Examples of Public Sector Banks are Punjab National Bank, State Bank of India and Central Bank of India, etc.

3. **Foreign Banks**:- Banks having Head offices outside India are known as Foreign Banks. Examples of Foreign Sector Banks are Standard Chartered Bank, American Express, Citi Bank etc.

13.2.1 Public Sector Banks in India: In public sector banks, the government owns more than 51% of shareholdings. Know about Public Sector Banks List of India. A bank is generally a financial institution licensed by the government to receive deposits and make loans. The public sector banks or Government Banks are those banks which are operated by the government and its owners are also associates of the Indian government. A bank is also classified as a public sector bank if the government owns more than 51% of the bank's stock. In India, at present, there are 12 public sector banks. All banks are headed by the Reserve Bank of India, which is controlled by the Indian government's financial department. The Indian government usually appoints one chief of this public sector bank, who is given the charge of making all of the bank's operational decisions.

List of Public Sector Banks in India 2020

13.2.2. Government banks or public sector banks List in India (as at end-March 2022)

S. No	Public Sector Banks	Government Share Holding	Established On	Headquarters
01	Bank of Baroda	**63.97%**	1908	Vadodara, Gujarat
02	Bank of India	**81.41%**	1906	Mumbai, Maharashtra
03	Bank of Maharashtra	**90.90%**	1935	Pune, Maharashtra

04	Canara Bank	**62.93%**	1906	Bengaluru, Karnataka
05	Central Bank of India	**93.08%**	1911	Mumbai, Maharashtra
06	Indian Bank	**79.86%**	1907	Chennai, Tamil Nadu
07	Indian Overseas Bank	**96.38%**	1937	Chennai, Tamil Nadu
08	Punjab and Sind Bank	**98.25%**	1908	New Delhi, Delhi
09	Punjab National Bank	**73.15%**	1894	New Delhi, Delhi
10	State Bank of India	**57.59%**	1955	Mumbai, Maharashtra
11	UCO Bank	**95.39%**	1943	Kolkata, West Bengal
12	Union Bank of India	**83.49%**	1919	Mumbai, Maharashtra

Finance minister Nirmala Sitharaman made an announcement of public sector bank mergers on 30th August 2019, the number of public sector banks has reduced to 12. In this article, candidates will be provided with the details of the government banks list in India 2022 after the merger of banks. . It also provides other financial support to the customer. Government banks or public sector banks are a major type of government-owned banks in India, where a majority stake is held by the Ministry of Finance of the Government of India or State Ministry of Finance of various State Governments of India. In public sector banks, the government owns more than 51% of shareholdings. Reserve bank of India is India's central banking institution and supreme banking authority.

13.3. WHAT IS PRIVATE BANKING?

Private banking consists of personalized financial services and products offered to the high-net-worth individual (HNWI) clients of a retail bank or other financial institution. It includes a wide range of wealth management services, and all provided under one roof. Services include investing and portfolio management, tax services, insurance, and trust and estate planning. While private banking is aimed at an exclusive clientele, consumer banks and brokerages of every size offer it. This offering is usually through special departments, dubbed "private banking" or "wealth management" divisions. Private banking is an enhanced offering for the high-net-worth individual (HNWI) clients of a financial institution. Private banking consists of personalized financial and investment services and products from a dedicated personal banker. Private banking clients typically receive discounts or preferential pricing on financial products. However, the range of products and investment expertise offered by a private bank may be limited compared to other providers.

13.3.1. How Private Banking Works

Private banking includes common financial services like checking and savings accounts, but with a more personalized approach: A "relationship manager" or "private banker" is assigned to each customer to handle all matters. The private banker handles everything from involved tasks, like arranging a jumbo mortgage, to the mundane like paying bills. However, private banking goes beyond CDs and safe deposit boxes to address a client's entire financial situation. Specialized services include investment strategy and financial planning advice, portfolio management, customized financing options, retirement planning, and passing wealth on to future generations. While an individual may be able to conduct some private banking with $50,000 or less in investable assets, most financial institutions set a benchmark of six figures' worth of assets, and some exclusive entities only accept clients with at least $1 million to invest.

13.4. ADVANTAGES OF PRIVATE BANKING

Private banking offers clients a variety of perks, privileges, and personalized service, which has become an increasingly prized commodity in an automated, digitized banking world. However, there are advantages to both the private bank clients as well as the banks themselves.

i. Privacy: Privacy is the primary benefit of private banking. Customer dealings and services provided typically remain anonymous. Private banks often provide HNWIs with tailored proprietary solutions, which are kept confidential to prevent competitors from luring a prominent customer with a similar solution.

ii. Preferential Pricing: Private banking clients typically receive discounted or preferential pricing on products and services. For example, they may receive special terms or prime interest rates on mortgages, specialized loans, or lines of credit (LOC). Their savings or money market accounts might generate higher interest rates and be free of fees and overdraft charges. Also, customers who operate import-export ventures or do business overseas might receive more favorable foreign exchange rates on their transactions.

iii. Alternative Investments: If they are managing a client's investments, private banks often provide the client with extensive resources and opportunities not available to the average retail investor. For example, an HNWI may be given access to an exclusive hedge fund or a private equity partnership or some other alternative investment.

iv. One-Stop-Shop: In addition to the customized products, there is the convenience of consolidated services—everything under one financial roof. Private banking clients received enhanced services from their private banker that acts as a liaison with all of the other departments within the bank to ensure that the client receives the best possible product offerings and service.

v. Assets and Fees for Banks: The bank or brokerage firm benefits from having the clients' funds add to their overall assets under management (AUM). Even at discounted rates, the private bank's management fees for portfolio management and interest on loans underwritten can be substantial. In an environment where interest rates in the U.S. have remained low, banks have been unable to charge higher loan rates to grow their profits. As a result, fee income has become an increasingly important financial metric in helping banks diversify their revenue stream. Banks have made strides in expanding beyond traditional banking products, such as loans and deposits, to more service-oriented and fee-based offerings like private banking.

13.5. DISADVANTAGES OF PRIVATE BANKING

Although there are many advantages to private banking, drawbacks do exist to this exclusivity.

i. Bank Employee Turnover: Employee turnover rates at banks tend to be high, even in the elite private banking divisions. There may also be some concern over conflicts of interest and loyalty: The private banker is compensated by the financial institution, not the client—in contrast to an independent money manager.

ii. Limited Product Offerings: In terms of investments, a client might be limited to the bank's proprietary products. Also, while the various legal, tax, and investment services offered by the bank are doubtlessly competent, they may not be as creative or as expert as those offered by other professionals that specialize in various types of investments. For example, small regional banks might provide stellar service that beats out the larger institutions. However, the investment choices at a smaller, regional bank might be far less than a major player such as JPMorgan Chase & Company (JPM).

iii. Regulatory Constraints for Banks: Lucrative as private banking can be, it can pose challenges for the institution, as well. Private banks have dealt with a restrictive regulatory environment since the global financial crisis of 2008. The Dodd-Frank Wall Street Reform and Consumer Protection Act, along with other legislation passed in the U.S. and around the world, has resulted in a higher level of transparency and accountability. There are more stringent licensing requirements for private banking professionals that help ensure customers are appropriately advised about their finances.

13.6. LIST OF PRIVATE SECTOR BANKS IN INDIA, 2023

S. No	Private Sector Banks	Established On	Headquarters
01	Axis Bank	1993	Mumbai, Maharashtra
02	Bandhan Bank	2015	Kolkata, West Bengal
03	CSB Bank	1920	Thrissur, Kerala
04	City Union Bank	1904	Thanjavur, Tamil Nadu
05	DCB Bank	1930	Mumbai, Maharashtra
06	Dhanlaxmi Bank	1927	Thrissur, Kerala
07	Federal Bank	1931	Aluva, Kerala
08	HDFC Bank	1994	Mumbai, Maharashtra
09	ICICI Bank	1994	Mumbai, Maharashtra
10	IndusInd Bank	1964	Mumbai, Maharashtra
11	IDFC FIRST Bank	2015	Mumbai, Maharashtra
12	Jammu & Kashmir Bank	1938	Srinagar, Jammu and Kashmir
13	Karnataka Bank	1924	Mangaluru, Karnataka
14	Karur Vysya Bank	1916	Karur, Tamil Nadu
15	Kotak Mahindra Bank	2003	Mumbai, Maharashtra
16	IDBI Bank	1964	Mumbai, Maharashtra

17	Nainital bank	1922	Nainital, Uttarakhand
18	RBL Bank	1943	Mumbai, Maharashtra
19	South Indian Bank	1929	Thrissur, Kerala
20	Tamilnad Mercantile Bank	1921	Thoothukudi, Tamil Nadu
21	YES Bank	2004	Mumbai, Maharashtra

In terms of revenue, HDFC Bank is the largest bank of the private sector in India while State Bank of India (SBI) is the largest public sector bank in the country. The above-mentioned list of private sector banks and public sector banks changes from time to time. As and when there's a change in the list, the same will be notified here.

13.6.1. Top 10 Best Private Sector Banks in India 2023

Being the second highest populated country and one of the largest economies in the world, there is an incredible economic variance among the people in India. Thankfully for us, as many as 12 Public Sector and 21 Private Sector Banks are efficiently serving the heterogeneous population of the nation. Not just Indian, but we also have some reputed foreign banks in India. Here we can see the list of the top 10 banks in India as per the Reserve Bank of India (RBI). If you have been wondering about the best private bank in India, we have consolidated just the right list for you. All you need to do is take a quick look and know for yourself!

Bank Name	**Total Branches**	**Total ATMs**	**City of Headquarter**
HDFC Bank	6,342	18,130	Mumbai
ICICI Bank	5,275	15,589	Mumbai
Axis Bank	4,758	10,990	Mumbai
Kotak Mahindra Bank	1,600	2,519	Mumbai
Yes Bank	1,000+	1,800	Mumbai
Federal Bank	1,282	1,885	Aluva
IndusInd Bank	2,015	2,886	Pune
RBL Bank	502	414	Mumbai
J&K Bank	964	1,388	Srinagar
South Indian Bank	933	1,200+	Thrissur

Additional Info: Also Check **Best Banks for Home Loan in India in 2023**

i. HDFC Bank - Largest Private Bank in India

Established in the year 1994, Housing Development and Finance Corporation Ltd. is headquartered in Mumbai. With revenue of a whopping Rs. 1.68 Lakh Crores and a net income of Rs. 38,151 Crores in the year 2022, HDFC is the **biggest bank in India** and offers numerous services ranging from Retail to Wholesale Banking, Credit to Debit Cards, Home Loans to Auto Loans, amongst others, the bank serves millions of customers across the nation. Today, this **international bank in India** boasts as many as 6,342 branches, 18,130 ATMs, and generates employment for over 1.41 Lakh people in the nation.

Bank Products	Interest Rates
HDFC Home Loan	8.65% - 9.35%
HDFC Personal Loan	10.35% - 21%

Facilities Offered:

Loans: HDFC Bank offers Home Loan, Personal Loan, Loan Against Property, Loan Against Securities, Education Loan, Pre-owned Car Loan, Two Wheeler Loan, Three Wheeler Loan, Gold Loan, Loan on Credit Card, Loan Against Car, Business Growth Loan, and so on.

Cards: The bank offers various cards under Credit Cards, Debit Cards, Millennia Cards, Commercial Credit Cards, Prepaid Cards, and Forex Cards categories.

Accounts: You can open Savings Account, Salary Account, Current Accounts, Rural Accounts, Sukanya Samridhi Account, Public Provident Fund, and Demat Accounts with the bank.

Deposits: The bank offers deposit facilities under Fixed Deposit, Recurring Deposit, Non-Withdrawal Deposits, and My Passion Fund.

Insurance: The bank has many insurance products under Life Insurance, Health & Accident Insurance, Vehicle Insurance, Travel Insurance, Home Insurance, and Cyber Insurance categories.

Other Facilities: Apart from the abovementioned, HDFC Bank also offers various other facilities including Bonds & Securities, Mutual Funds, Safe Deposit Locker, Money Transfer, Bill Payments, Recharge, NRI Banking facilities, SME Banking facilities, Wholesale Banking facilities, Agricultural Banking facilities, and so on,

Additional Info: You can also check **Best Home Loan Interest Rates**

ii. ICICI Bank

One of the most reliable of all private banks, ICICI Bank (Industrial Credit and Investment Corporation of India), offers a wide range of services including truncations, loans, deposits, privilege banking, insurance policies, and Credit Cards amongst others. With revenue of Rs. 157,536 Crores and a net income of Rs. 25,783 Crores in last year, this top bank of India, boasts of consolidated assets worth Rs. 12.50 trillion. With as many as 5,275 branches and 15,589 ATMs across India, ICICI Bank generates employment for close to 97,354 people. It is one of the best banks in India.

Also Check: **ICICI CIBIL Score**

Bank Products	Interest Rates
ICICI Home Loan	8.75% - 9.85%
ICICI Personal Loan	10.75%

Facilities Offered:

Loans: ICICI Bank offers various loan facilities under the categories of Home Loan, Personal Loan, Car Loan, Loan Against Property, Education Loan, Consumer Finance, Gold Loan, Loan Against Securities, Commercial Business Loan, Pradhan Mantri Mudra Yojana, and Stand Up India Scheme.

Cards: The bank offers Credit Cards, Debit Cards, Commercial Cards, Prepaid Cards, Travel Cards, and Unifare Metro Cards.

Accounts & Deposits: ICICI Bank provides Savings Account, Salary Account, 3-in-1 Account, Pension Account, Defence Salary Account, **best NRI account in india,** Fixed Deposit, Recurring Deposit, iWish Flexible RD, and other accounts and deposits facilities.

Insurance: The bank has Life Insurance, Health Insurance, Car Insurance, Travel Insurance, and General Insurance services.

Other Facilities: Apart from the facilities mentioned above, the bank also offers Tax solutions, Investments, Agri & Rural finance, My Money, Pockets, and other facilities.

iii. Axis Bank

Headquartered in Mumbai, Axis Bank was established in the year 1993. In the short span of its existence, the bank has managed to flourish all across India, with Over 4,758 branches and 10,990 ATMs. With revenue of Rs. 86,114 Crores and a net income of Rs. 14,162 Crores, Axis Bank generates employment to over 78,300 people. Axis Bank is the third-largest bank in India in 2023.

Bank Products	**Interest Rates**
Axis Home Loan	8.60% - 9.05%
Axis Personal Loan	12% - 24%

Facilities Offered:

Loans: Axis Bank offers various loans, including Home Loan, Personal Loan, Car Loan, Holiday Loan, Loan Against Property, Education Loan, Business Loan, Gold Loan, Loan Against Securities, Two-Wheeler Loan, Loan Against Fixed Deposit, and Commercial Vehicle & Construction Equipment Loan.

Cards: The bank offers Credit Cards, Debit Cards, Commercial Credit Cards, Commercial Debits Cards, Prepaid Cards, and Transit Cards.

Accounts: The bank offers Savings Account, Salary Account, Current Account, and other bank accounts

Deposits: Under its range of attractive deposit products, the bank provides Fixed Deposits, Express FD, Recurring Deposits, Fixed Deposit Plus, Tax Saver Fixed Deposit, and Auto Fixed Deposit.

Insurance: The bank has Life Insurance, Home Insurance, Motor Insurance, Travel Insurance, and Two-Wheeler Insurance, Health Insurance, and other insurance services.

Other Facilities: The bank also offers Forex, Investments, Agri & Rural, FASTag, Business Banking, Priority Banking, NRI Banking, and Wealth Management services.

Additional Info: Check **List of Merged Public Sector Banks in India** 2022

iv. Kotak Mahindra Bank

With exceptionally high revenue of Rs. 58,882 Crores Kotak Mahindra Bank has earned the reputation of being a leading private bank in India. Founded in the year 2003, the bank enjoys as many as 1,600 branches complete with 2,519 ATMs across the nation. To add to its already illustrious legacy, the bank generates employment for over 71,000 people.

Bank Products	**Interest Rates**
Kotak Home Loan	8.65% - 9.45%
Kotak Personal Loan	10.50% - 19.25%

Facilities Offered:

Loans: Kotak Mahinda Bank offers Home Loan, Home Loan Balance Transfer, Home Improvement, Personal Loan, Car Loan, Gold Loan, Consumer Finance, Kotak Payday Loan, Loan Against Security (Kotak Stock Ace), Education Loan, and other lending products.

Cards: The bank offers Credit Cards, Debit Cards, and Forex/Prepaid Cards.

Accounts: The bank offers Savings Account, Corporate Salary Accounts, Current Account, Retail Institutional Accounts, Bank+Demat+Trading A/c, and Safe Deposit Locker.

Deposits: Under this category the bank offers Regular Fixed Deposit, Recurring Deposit, Tax Saving Fixed Deposit, Senior Citizen Fixed Deposit, and Sweep-In Facility.

Insurance: The bank has Life Insurance, Atal Pension Yojana, Pradhan Mantri Suraksha Bima Yojana, and Pradhan Mantri Jeevan Jyoti Bima Yojana.

Other Facilities: The bank also offers Investments, Payments, and NRI Banking services.

Additional Reading: **Online CIBIL Score Check by Pan Number**

v. Yes Bank

Headquartered in Mumbai, Yes Bank was established in the year 2004, with the objective of offering asset management services and retail banking functions, along with investment banking, corporate finance, branch banking, and SME banking facilities. One of the fastest-growing private banks in the nation, Yes Bank, enjoyed a revenue of Rs. 25,423 crores in the previous year. The bank boasts of over 1,000 branches across the country, complemented by 1,800 ATMs. It generates employment for over 23,800 people. It was among the first banks in India to offer all products digitally and among the best private banks in India.

Bank Products	Interest Rates
Yes Bank Home Loan	8.95%
Yes Bank Personal Loan	10.99%

Facilities Offered:

Loans: Yes Bank offers Home Loan, Yes Khushi Affordable Home Loan, Personal Loan, Car Loan, Two-Wheeler Loan, Loan Against Securities, Loan Against Property, Business Loan, Gold Loan, Commercial Loans, MSME Loans, and other loan products.

Cards: Bank offers Credit Cards, Debit Cards, MCTC Card, and Prepaid Cards.

Accounts: Bank offers Savings Account, Salary Accounts, and Current Accounts.

Deposits: Yes Bank offers Fixed Deposit and Recurring Deposit facilities.

Insurance: Bank offers Life Insurance, Health Insurance, and General Insurance schemes.

Other Facilities: Bank also offers Wealth Management, YES Privileges, YES Premia, Safety Deposit Lockers, Government Schemes, NRI Banking, Business Banking, Corporate Banking, and Digital Banking services.

Additional Info: Looking for **10 Lakh Personal Loan** ? Check EMI & Apply.

vi. Federal Bank

Founded in the year 1931 as Travancore Federal Bank, the present-day Federal Bank is headquartered in Kochi, Kerala. With 1,282 branches and 1,885 ATMs across the country, Federal Bank offers multiple services including but not limited to personal banking, retail banking, corporate banking, NRI banking, insurance, and loans. The bank's last recorded revenue was Rs. 15,142.16 Crores, and it generated employment for 12,592 people.

Federal Bank Home Loan	8.50% - 10.05%
Federal Bank Personal Loan	10.49%

Facilities Offered:

Loans: Federal Bank offers Personal Loans, Housing Loans, Car Loans, Gold Loans, Property Loans, Education Loans, SME Business Loans, Agri Loans, and other loan products.

Cards: Bank offers Credit Cards, Debit Cards, Contactless Cards, Forex Card, Gift Cards, and EMI on Debit Card.

Accounts: The bank offers Savings Accounts, Salary Accounts, Noor Personal Account, RFC Account, and so on.

Deposits: Yes Bank offers Fixed Deposit, Recurring Deposit, Millionaire Deposit, and Tax Saving Deposit facilities.

Insurance: The bank offers Life Insurance, Health Insurance, Wealth Insurance, and General Insurance schemes.

Other Facilities: The bank also offers NRI Banking, Business Banking, Online Trading, Investment, and other services.

vii. Indusind Bank

Headquartered in Mumbai, IndusInd Bank was established in the year 1994. The bank boasts of 2,015 branches and 2,886 ATMs. The bank enjoys a prominent presence in all metropolitan cities of India, along with an international presence in Dubai, Abu Dhabi, and London. Owing to its widespread operations, the bank generates employment for over 33,582people.
Facilities Offered:

Facilities Offered

Loans: **IndusInd Bank offers Personal Loan**, Vehicle Loan, Loan Against Property, Home Loans, Gold Loan, Loan Against Securities, Professional Loan to Doctors, Agri Loan, Loan on Credit Card, and other loan products.

Cards: The bank offers Credit Card, Debit Card, Duo Card, Forex Card, and Prepaid Card.

Accounts: The bank offers Defence Salary Account, Individual Saving Account, Corporate Salary Account, and Regular Current Account.

Deposits: Yes Bank offers Fixed Deposit, Recurring Deposit, Sweep in/ Sweep Out, Senior Citizen Scheme, Young Saver Deposit, and Deposit Plus schemes.

Other Facilities: The bank also offers Insurance schemes, Investments products, Payment products, Foreign Exchange, NRI Banking, Pioneer Banking, Business Banking, Corporate Banking, and Inclusive Banking services.

Tip: **Check Credit Score** before applying for a loan

viii. Rbl Bank

One of the fastest-growing private banks of the nation, RBL Bank, was established in the year 1943 with the aim of serving the Kolhapur-Sangli belt of Maharashtra. Today, the bank boasts of as many as 414 branches and 502 ATMs in India, with its headquarters in Mumbai. Catering to over 20 Lakh people across the nation, RBL Bank offers numerous services, including Consumer Banking, Corporate Banking, Finance, and Insurance, complete with facilities like NRI deposits, Digital Savings Account, Investment Services, and Loans amongst others. The bank clocked in a revenue of Rs. 10,516 Crores in 2022, while also generating employment for over 9,257 people. It was the fastest growing top private bank in 2021.

Facilities Offered:

Loans: RBL Bank offers Loan Against Property, Overdraft Against Property, Personal Loan, Business Loan, Home Loan, Car Loan, Education Loan, Working Capital Finance, and other loan products.

Cards: The bank offers Debit Cards and a huge variety of Credit Cards.

Accounts: The bank offers Savings Accounts, Salary Accounts, and Special Institutions Accounts.

Deposits: RBL Bank offers Fixed Deposits, Senior Citizen Fixed Deposits, Tax Savings Fixed Deposits, Recurring Deposits, Flexi Sure Fixed Deposits.

Insurance: The bank offers Life Insurance, Health Insurance, and General Insurance schemes.

Other Facilities: The bank also offers Aspire Banking, Signature Banking, Safe Deposit Lockers, NRI Banking, Wholesale Banking, Business Banking, and other services.

ix. J&K Bank

Headquartered in Srinagar (Kashmir), the Jammu and Kashmir Bank, now known as J&K Bank, was founded in the year 1938. The bank boasts of 964 branches across India, along with 1,388 ATMs. In the year 2020, the bank registered revenue of Rs. 8,830.08 Crores.

Additional Info: Looking for **20 Lakh Home Loan** ? Check EMI & Apply.

Facilities Offered:

Loans: J&K Bank offers a plethora of lending products for all your financial requirements, including Housing Loan, Consumer Loan, Laptop/PC Finance, Saholiat/Saral Finance, Education Loan Scheme, Festival Advance Scheme, Car Loan, Two-Wheeler Finance, Skill Loan Scheme, Commercial Vehicle Finance, Construction Equipment Finance, Contractor Finance, Dastkar Finance, School Bus Finance, Saral Finance to Small Businessmen, Loan Against Mortgage of Immovable Property, All Purpose AgroTerm Loan, Fruit Advances Scheme (Apple), Giri Finance Scheme, Apiculture Finance, Zafran Finance, and so on.

Cards: The bank offers Global Debit Card, Credit Card, and Prepaid Cards.

Accounts: The bank offers Deluxe/General/Student/Basic Savings Accounts, Deluxe/General Salary Accounts, General Small Account, Pension Account, Savings Account – Government, NRE/NRO Savings Account, and Business Accounts.

Deposits: The bank offers Fixed Deposits, NRE/NRO Fixed Deposits, Tax Saver Term Deposit, Recurring Deposit, and other deposit schemes.

Insurance: The bank offers Life Insurance and Non-Life Insurance products.

Other Facilities: The bank also offers NRI Banking, Investor Banking, Payment Solutions, Government Sponsored Schemes, and other services.

Also Check: **CIBIL Score Required for Personal Loan**

x. South Indian Bank

Yet another leading private bank of the nation is the South Indian Bank, which has its headquarters in Thrissur, Kerala. In addition to its brilliant network of 933 branches across the nation, the bank also boasts of 1,200+ ATMs with its presence in 27 states and 3 union territories in India! Its last reported revenue was Rs. 6,562 Crores. At present, South Indian Bank generates employment for over 7,677 people.

Bank Products	Interest Rates
South Indian Bank Home Loan	9.25%-12.00% p.a.
South Indian Bank Personal Loan	12.85%-20.35% p.a.

Facilities Offered:

Loans: South Indian Bank offers Home Loans, Personal Loan, Car Loan, Gold Loans, Education Loans, Property Loan, Business Finance, and other loans.

Accounts & Deposits: The bank offers Savings Account, Inoperative Accounts, Term Deposits, and Unclaimed Deposits.

Insurance: The bank offers Life Insurance, Health Insurance, General, ECGC, AND PM's Social Security Schemes.

Other Facilities: The bank also offers Mutual Funds, Money Transfer, Priority Banking, NRI Banking, Business Banking, and Online Banking services.

13.7. SUMMARY

After studying this lesson, you should be able to: Know the meaning of Private Banking. Understand Advantages and disadvantages of Private Banking. Study the Top 10 Best Private Sector Banks in India 2023

13.8. TECHNICAL TERMS

Private Banking: Private banking refers to a type of banking and financial service offered by certain banks only to high-net-worth individuals (HNWIs). Clients opting for this service are individually assigned a financial representative who personally takes care of their banking needs

13.9. SELF-ASSESSMENT QUESTIONS

1. What Is Private Banking?
2. Explain THE Advantages of Private Banking.
3. Disadvantages of Private Banking
4. Briefly discuss about Top 10 Best Private Sector Banks in India 2023

13.10. SUGGESTED READINGS

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6. Fact checked by KIRSTEN ROHRS SCHMITT

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LESSON-14
RESERVE BANK OF INDIA

AIMS AND OBJECTIVES

After studying this lesson, you should be able to:

- Know the origin of Central Banking.
- Understand the role of central Bank.
- Understand the functions of Reserve Bank of India.

STRUCTURE

14.1 INTRODUCTION TO CENTRAL BANKING IN INDIA

In 1926, the Royal Commission on Indian Currency and Finance (Hilton Young Commission) recommended that dichotomy of functions and division of responsibilities for control of currency and credit should be ended. The Commission suggested the establishment of a central bank to be called the Reserve Bank of India, whose separate existence was considered necessary for augmenting banking facilities throughout the country. The Bill to establish the Reserve Bank of India (RBI) was introduced in January 1927 in the Legislative Assembly, but it was dropped due to differences in views regarding ownership, constitution and composition of its Board of Directors.

The White Paper on Indian Constitutional Reforms (1933) proposed the setting up of the RBI free from political influences. The Indian Central Banking Enquiry Committee (1931) had also strongly recommended the establishment of a Reserve Bank. These events led to the introduction of a fresh Bill in 1933. The Bill was passed in 1934 and the RBI Act came into force on January 1, 1935. The Reserve Bank was inaugurated on April 1, 1935.

Central banks occupy a pivotal position in the institutional fabric of an economy. The functions of a modern central bank are vastly different from what was expected from the early central banks founded in Europe in the seventeenth century. The evolution of central banking in the Indian context has its own specificity. The RBI, while discharging its statutory responsibilities, has played a crucial role in the nation building process, particularly in the development of the financial sector. In fact, institution building constitutes a distinguishing feature of central banking in India.

This following section describes the evolution of central banking in India over the period of seventy years since the inception of the Reserve Bank in 1935. For analytical convenience, the entire period 1935-2005 is sub-divided into three broad phases: foundation phase (1935-1950), development phase (1951-1990) and reform phase (1991 onwards).

14.2 RESERVE BANK OF INDIA

The RBI is wholly owned by the Government of India. The Central Board of Directors oversees the Reserve Bank's business. The Central Board has primary authority for the oversight of the Reserve Bank. It delegates specific functions to its committees and sub-committees.

14.2.1 Central Board of Directors by the Numbers Official Directors:

a) 1 Governor and

b) 4 Deputy Governors, at a maximum.

14.2.2 Non-Official Directors:

a) 4 directors—nominated by the Central Government to represent each local board;

b) 10 directors nominated by the Central Government with expertise in various segments of the economy; and

c) 1 representative of the Central Government.

14.2.3 Number of Meetings:

a) 6 meetings—at a minimum—each year; and

b) 1 meeting—at a minimum—each quarter.

14.2.4 The details about the central board and its committees and sub-committees include the following:

- **Central Board**: Includes the Governor, Deputy Governors and the nominated Directors and a government nominee-Director.
- **Committee of Central Board**: Oversees the current business of the central bank and typically meets every week, on Wednesdays. The agenda focuses on current business, including approval of the weekly statement of accounts related to the Issue and Banking Departments.
- **Board for Financial Supervision**: Regulates and supervises commercial banks, Non-Banking Finance Companies (NBFCs), development finance institutions, urban co-operative banks and primary dealers.
- **Board for Payment and Settlement Systems**: Regulates and supervises the payment and settlement systems.
- **Sub-committees of the Central Board**: Includes those on Inspection and Audit; Staff; and Building. Focus of each sub-committee is on specific areas of operations.
- **Local Boards:** In Chennai, Kolkata, Mumbai and New Delhi, representing the country's four regions. Local board members, appointed by the Central Government for four-year terms, represent regional and economic interests and the interests of co-operative and indigenous banks.

14.3 FUNCTIONS OF RESERVE BANK OF INDIA

The Reserve Bank is the umbrella network for numerous activities, all related to the nation's financial sector, encompassing and extending beyond the functions of a typical central bank.

1) Monetary Authority
2) Issuer of Currency
3) Banker and Debt Manager to Government
4) Banker to Banks
5) Regulator of the Banking System
6) Manager of Foreign Exchange
7) Regulator and Supervisor of the Payment and Settlement Systems
8) Developmental Role

14.3.1 Monetary Authority

Monetary policy refers to the use of instruments under the control of the central bank to regulate the availability, cost and use of money and credit. The goal of monetary policy is to achieve specific economic objectives such as low and stable inflation and promoting growth. The main objectives of monetary policy in India are:

- Maintaining price stability;
- Ensuring adequate flow of credit to the productive sectors of the economy to support economic growth
- Financial stability.

The relative emphasis among the objectives varies from time to time, depending on evolving macro-economic developments. The operating framework is based on a multiple indicator approach. This means that RBI monitors and analyses the movement of a number of indicators including interest rates, inflation rate, money supply, credit, exchange rate, trade, capital flows and fiscal position, along with trends in output as it develops its policy perspectives.

The Reserve Bank's Monetary Policy Department (MPD) formulates monetary policy. The Financial Markets Department (FMD) handles day-to-day liquidity management operations. There are several direct and indirect instruments that are used in the formulation and implementation of monetary policy.

14.3.2 Issuer of Currency

The RBI is the nation's sole note issuing authority. Along with the Government of India, RBI is responsible for the design and production and overall management of the nation's currency, with the goal of ensuring an adequate supply of clean and genuine notes. The Reserve Bank also makes sure there is an adequate supply of coins, produced by the government. In consultation with the government, RBI routinely addresses security issues and targets ways to enhance security features to reduce the risk of counterfeiting or forgery.

The Department of Currency Management in Mumbai, in cooperation with the Issue Departments in the Reserve Bank's regional offices, oversees the production and manages the distribution of currency. Currency chests at more than 4,000 bank branches—typically commercial banks—contain adequate quantity of notes and coins so that currency is accessible to the public in all parts of the country.

The Reserve Bank has the authority to issue notes up to value of Rupees Ten Thousand. Four printing presses actively print notes: Dewas in Madhya Pradesh, Nasik in Maharashtra, Mysore in Karnataka, and Salboni in West Bengal. The presses in Madhya Pradesh and Maharashtra are owned by the Security Printing and Minting Corporation of India (SPMCIL), a wholly owned company of the Government of India.

14.3.2.1 RBI's Anti-counterfeiting Measures

- ❖ Continual upgrades of bank note security features.

- ❖ Public awareness campaigns to educate citizens to help prevent circulation of forged or counterfeit notes.
- ❖ Installation of note sorting machines. RBI's Clean Note Policy
- ❖ Education campaign on preferred way to handle notes: no stapling, writing, excessive folding and the like.
- ❖ Timely removal of soiled notes: use of currency verification and processing systems and sorting machines.
- ❖ Exchange facility for torn, mutilated or defective notes: at currency chests of commercial banks and in Reserve Bank issue offices. Focus continues on ensuring availability of clean notes and on strengthening the security features of bank notes. Given the volumes involved and costs incurred in the printing, transport, storage and removal of unfit/soiled notes, the RBI is evaluating ways to extend the life of bank notes—particularly in the lower denominations. For example, RBI is considering issues of `10 banknotes in polymer.

14.3.3 Banker and Debt Manager to Government

Managing the government's banking transactions is a key RBI role. Like individuals, businesses and banks, governments need a banker to carry out their financial transactions in an efficient and effective manner, including the raising of resources from the public. As a banker to the central government, the Reserve Bank maintains its accounts, receives money into and makes payments out of these accounts and facilitates the transfer of government funds. RBI also acts as the banker to those state governments that have entered into an agreement with it.

The role as banker and debt manager to government includes several distinct functions:

- ❖ Undertaking banking transactions for the central and state governments to facilitate receipts and payments and maintaining their accounts.
- ❖ Managing the governments' domestic debt with the objective of raising the required amount of public debt in a cost-effective and timely manner.
- ❖ Developing the market for government securities to enable the government to raise debt at a reasonable cost, provide benchmarks for raising resources by other entities and facilitate transmission of monetary policy actions.

At the end of each day, our electronic system automatically consolidates all of the government's transactions to determine the net final position. If the balance in the government's account shows a negative position, RBI extends a short-term, interest-bearing advance, called a Ways and Means Advance - WMA – the limit or amount for which is set at the beginning of each financial year in April.

14.3.3.1 The RBI's Government Finance Operating Structure

The RBI's Department of Government and Bank Accounts oversees governments' banking related activities. This department encompasses:

- Public accounts departments: manage the day-to-day aspects of our government's banking operations. The Reserve Bank also appoints commercial banks as its agents and uses their branches for greater access to the government's customers.
- Public debt offices: provide depository services for government securities for institutions and service government loans.
- Central Accounts Section at Nagpur: consolidates the government's banking transactions.

The Internal Debt Management Department based in Mumbai raises the government's domestic debt and regulates and develops the government securities market. RBI plans to enhance efficient and user-friendly conduct of banking transactions for central and state governments while ensuring cost-effective cash and debt management by deepening and widening of the market for government securities. RBI as the Governments' Debt Manager In this role, RBI sets policies, in consultation with the government and determine the operational aspects of raising money to help the government finance its requirements:

- Determine the size, tenure and nature (fixed or floating rate) of the loan.
- Define the issuing process including holding of auctions.
- Inform the public and potential investors about upcoming government loan auctions The Reserve Bank also undertakes market development efforts, including enhanced secondary market trading and settlement mechanisms, authorization of primary dealers and improved transparency of issuing process to increase investor confidence, with the objective of broadening and deepening the government securities market.

14.3.4 Banker to Banks

Like individual consumers, businesses and organizations of all kinds, banks need their own mechanism to transfer funds and settle interbank transactions - such as borrowing from and lending to other banks – and customer transactions. As the banker to banks, the Reserve Bank fulfils this role. In effect, all banks operating in the country have accounts with the Reserve Bank, just as individuals and businesses have accounts with their banks. As the banker to banks, RBI focuses on:

- ❖ Enabling smooth, swift and seamless clearing and settlement of inter-bank obligations.
- ❖ Providing an efficient means of funds transfer for banks.
- ❖ Enabling banks to maintain their accounts with us for purpose of statutory reserve requirements and maintain transaction balances.
- ❖ Acting as lender of the last resort.

The RBI provides similar products and services for the nation's banks to what banks offer their own customers. Here's a look at how RBI helps:

- ❖ **Non-interest earning current accounts:** Banks hold accounts with the RBI based on certain terms and conditions, such as maintenance of minimum balances. They can hold accounts at each of our regional offices. Banks draw on these accounts to settle their obligations arising from inter-bank settlement systems. Banks can electronically transfer payments to other banks from this account, using the Real Time Gross Settlement System (RTGS).
- ❖ **Deposit Account Department:** This department's computerized central monitoring system helps banks manage their funds position in real time to maintain the optimum balance between surplus and deficit centres.
- ❖ **Remittance facilities:** Banks and government departments can use these facilities to transfer funds.
- ❖ **Lender of the last resort:** The Reserve Bank provides liquidity to banks unable to raise short-term liquid resources from the interbank market. Like other central banks, the Reserve Bank considers this a critical function because it protects the interests of depositors, which in turn, has a stabilizing impact on the financial system and on the economy as a whole.
- ❖ **Loans and advances:** The Reserve Bank provides short-term loans and advances to banks / financial institutions, when necessary, to facilitate lending for specified purposes. RBI is planning to implement core banking solutions for its customers to enhance the safety and efficiency of the payments and settlement services in the country.

14.3.5 Regulator of the Banking System:

Banks are fundamental to the nation's financial system. The central bank has a critical role to play in ensuring the safety and soundness of the banking system—and in maintaining financial stability and public confidence in this system. As the regulator and supervisor of the banking system, the RBI protects the interests of depositors, ensures a framework for orderly development and conduct of banking operations conducive to customer interests and maintains overall financial stability through preventive and corrective measures. The Reserve Bank regulates and supervises the nation's financial system. Different departments of the Reserve Bank oversee the various entities that comprise India's financial infrastructure.

14.3.5.1 RBI oversees:

- ❖ Commercial banks and all-India development financial institutions: Regulated by the Department of Banking Operations and Development, supervised by the Department of Banking Supervision
- ❖ Urban co-operative banks: Regulated and supervised by the Urban Banks Department
- ❖ Regional Rural Banks (RRB), District Central Cooperative Banks and State Co-operative Bank: Regulated by the Rural Planning and Credit Department and supervised by NABARD.
- ❖ Non-Banking Financial Companies (NBFC): Regulated and supervised by the Department of Non-Banking Supervision.

The Reserve Bank makes use of several supervisory tools such as on-site inspections; Off-site surveillance, making use of required reporting by the regulated entities; and thematic inspections, scrutiny and periodic meetings. The Board for Financial Supervision oversees the Reserve Bank's regulatory and supervisory responsibilities.

14.3.5.2 The Reserve Bank handles a range of activities, including

- ❖ Licensing
- ❖ Prescribing capital requirements
- ❖ Monitoring governance
- ❖ Setting prudential regulations to ensure solvency and liquidity of the banks
- ❖ Prescribing lending to certain priority sectors of the economy
- ❖ Regulating interest rates in specific areas
- ❖ Setting appropriate regulatory norms related to income recognition, asset classification, provisioning, investment valuation, exposure limits and the like
- ❖ Initiating new regulation

14.3.5.3 RBI challenges as regulatory:

a) For commercial banks: Focus is on implementing Basel II norms, which will require improved capital planning and risk management skills.
b) For urban cooperative banks: Focus is on profitability, professional management and technology enhancement.
c) For NBFCs: Focus is on identifying the interconnections and the roles these institutions should play as the financial system deepens.
d) For regional rural banks: Focus is on enhancing capability through IT and HR for serving the rural areas.
e) For rural cooperative banks: Focus is on ensuring that they meet minimum prudential standards.

14.3.6 Manager of Foreign Exchange

With the transition to a market-based system for determining the external value of the Indian rupee, the foreign exchange market in India gained importance in the early reform period. In recent years, with increasing integration of the Indian economy with the global economy arising from greater trade and capital flows, the foreign exchange market has evolved as a key segment of the Indian financial market.

The Reserve Bank plays a key role in the regulation and development of the foreign exchange market and assumes three broad roles relating to foreign exchange:

- Regulating transactions related to the external sector and facilitating the development of the foreign exchange market.
- Ensuring smooth conduct and orderly conditions in the domestic foreign exchange market.
- Managing the foreign currency assets and gold reserves of the country.

The Reserve Bank is responsible for administration of the Foreign Exchange Management Act, 1999 and regulates the market by issuing licences to banks and other select institutions to act as Authorized Dealers in foreign exchange. The Foreign Exchange Department (FED) is responsible for the regulation and development of the market. On a given day, the foreign exchange rate reflects the demand for and supply of foreign exchange arising from trade and capital transactions.

The RBI's Financial Markets Department (FMD) participates in the foreign exchange market by undertaking sales / purchases of foreign currency to ease volatility in periods of excess demand for/supply of foreign currency.

The Department of External Investments and Operations (DEIO) invests the country's foreign exchange reserves built up by purchase of foreign currency from the market. In investing its foreign assets, the Reserve Bank is guided by three principles: safety, liquidity and return.

The challenge for RBI is to liberalize and develop the foreign exchange market, with an eye toward ushering in greater market efficiency while ensuring financial stability in an increasingly global financial market environment. With current account convertibility achieved in 1994, the key focus is now on capital account management.

14.3.7 Regulator and Supervisor of Payment and Settlement Systems:

Payment and settlement systems play an important role in improving overall economic efficiency. They consist of all the diverse arrangements that we use to systematically transfer money - currency, paper instruments such as cheques, and various electronic channels. The Payment and Settlement Systems Act of 2007 (PSS Act) gives the Reserve Bank oversight authority, including regulation and supervision, for the payment and settlement systems in the country. In this role, RBI focuses on the development and functioning of safe, secure and efficient payment and settlement mechanisms.

The Reserve Bank has a two-tiered structure. The first tier provides the basic framework for our payment systems. The second tier focuses on supervision of this framework. As part of the basic framework, the RBI's network of secure systems handles various types of payment and settlement activities. Most operate on the security platform of the Indian Financial Network (INFINET), using digital signatures for further security of transactions.

14.3.7.1 Various systems used by RBI:

a) **Retail payment systems**: Facilitating cheques clearing, electronic funds transfer, through National Electronic Funds Transfer (NEFT), settlement of card payments and bulk payments, such as electronic clearing services. Operated through local clearing houses throughout the country.
b) **Large value systems**: Facilitating settlement of inter-bank transactions from financial markets.
   These include:

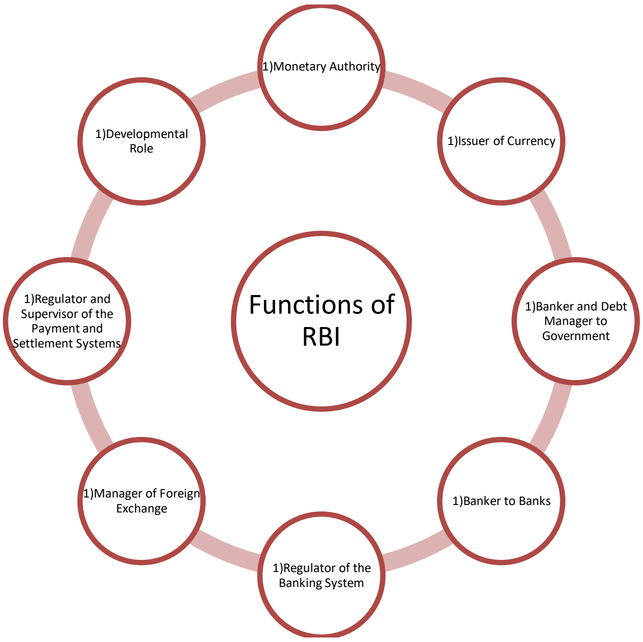
- ❖ Real Time Gross Settlement System (RTGS): for funds transfers
- ❖ Securities Settlement System: for the government securities market
- ❖ Foreign Exchange Clearing: for transactions involving foreign currency

c) **Department of Payment and Settlement Systems:** The Reserve Bank's payment and settlement systems regulatory arm.

D) **Department of Information Technology:** Tech support for the payment systems and for the Reserve Bank's internal IT systems. RBI is proactively identifying and addressing issues that help mitigate the risks for large value systems. Efforts on the retail payment system side will focus on operational efficiencies, cost effectiveness, innovation and risk management.

14.3.8 Developmental Role:

This role is, perhaps, the most unheralded aspect of our activities, yet it remains among the most critical. This includes ensuring that credit is available to the productive sectors of the economy, establishing institutions designed to build the country's financial infrastructure, expanding access to affordable financial services and promoting financial education and literacy. Over the years, the Reserve Bank has added new institutions as the economy has evolved.



14.4 SUBSIDIARIES OF RBI:

- ❖ Deposit Insurance and Credit Guarantee Corporation (1962), to provide protection to bank depositors and guarantee cover to credit facilities extended to certain categories of small borrowers.
- ❖ Unit Trust of India (1964), the first mutual fund of the country.
- ❖ Industrial Development Bank of India (1964), a development finance institution for industry.
- ❖ National Bank of Agriculture and Rural Development (1982), for promoting rural and agricultural credit.
- ❖ Discount and Finance House of India (1988), a money market intermediary and a primary dealer in government securities.
- ❖ National Housing Bank (1989), an apex financial institution for promoting and regulating housing finance.

- ❖ Securities and Trading Corporation of India (1994), a primary dealer. The Reserve Bank continues its developmental role, while specifically focusing on financial inclusion.

14.5. KEY TOOLS IN THIS ON-GOING EFFORT OF RBI

14.5.1 Directed credit for lending to priority sector and weaker sections: The goal here is to facilitate/enhance credit flow to employment intensive sectors such as agriculture, micro and small enterprises (MSE), as well as for affordable housing and education loans.

14.5.2. Lead Bank Scheme: A commercial bank is designated as a lead bank in each district in the country and this bank is responsible for ensuring banking development in the district through coordinated efforts between banks and government officials. The Reserve Bank has assigned a Lead District Manager for each district who acts as a catalytic force for promoting financial inclusion and smooth working between government and banks.

14.5.3. Sector specific refinance: The Reserve Bank makes available refinance to banks against their credit to the export sector. In exceptional circumstances, it can provide refinance against lending to other sectors.

14.5.4. Strengthening and supporting small local banks: This includes regional rural banks and cooperative banks

14.5.5 Financial inclusion: Expanding access to finance and promoting financial literacy are a part of our outreach efforts. The development role of the Reserve Bank will continue to evolve, along with the Indian economy. Through the outreach efforts and emphasis on customer service, the Reserve Bank will continue to make efforts to fill the gaps to promote inclusive economic growth and stability. Financial Inclusion and Literacy: Expanding Access & Encouraging Education Expanding access to and knowledge about finance is a fundamental aspect of the Reserve Bank's operations. These efforts are critical to ensuring that the benefits of a growing and healthy economy reach all segments of the population.

14.5.6 RBI's work here includes:

- ❖ Encouraging provision of affordable financial services like zerobalance, no-frills bank accounts, access to payments and remittance facilities, savings, loans and insurance services.
- ❖ Expanding banking outreach through use of technology, such as banking by cell phone, smartcards and the like.
- ❖ Encouraging bank branch expansion in parts of the country with few banking facilities.
- ❖ Facilitating use of specified persons to act as agents to perform banking functions in hard-to reach parts of the country.

RBI's effort to promote financial literacy focuses on educating people about responsible financial management. Efforts here include:

- ❖ **Information and knowledge-sharing**: User-friendly website includes easy-to-understand tips and guidance in multiple languages; brochures, advertisements and other marketing materials educate the public about banking services.
- ❖ **Credit counselling:** The Reserve Bank encourages commercial banks to set up financial literacy and credit counselling centres, to help people develop better financial planning skills.

14.6. SUMMARY

The Indian Central Banking Enquiry Committee (1931) strongly recommended the establishment of Reserve Bank. These recommendations led to the establishment of Reserve Bank on April 1, 1935. The main objective of RBI is to protect the interest of the depositor, develop and regulate the banking business in India. The major functions of RBI include Issuer of Currency, Banker and Debt Manager to Government, Banker to Banks, Regulator of the Banking System, Manager of Foreign Exchange, Regulator and Supervisor of the Payment and Settlement Systems and Developmental Role. The major challenges of RBI are to minimize the uncertainty in banking business.

14.7. TECHNICAL TERMS

CentralBank: A central bank or monetary authority is a monopolized and often nationalized institution given privileged control over the production and distribution of money and credit. In modern economies, the central bank is usually responsible for the formulation of monetary policy and the regulation of member banks**.**

R.B.I.: The Reserve Bank of India (RBI) is the nation's central bank and is also known as the banker's bank. It began its operations on April 1, 1935, under the Reserve Bank of India Act. RBI was established to ensure monetary stability by enforcing monetary policies to create financial stability in India.

Subsidiaries: Meaning of subsidiary in English. subsidiary. adjective. uk. Your browser doesn't support HTML5 audio. / səbˈsɪd.i.ə.ri / us. Your browser doesn't support HTML5 audio. / səbˈsɪd.i.er.i /. used to refer to something less important than something else with which it is connected

Functions: A function is a relation between a set of inputs and a set of permissible outputs with the property that each input is related to exactly one output. Let A & B be any two non-empty sets; mapping from A to B will be a function only when every element in set A has one end, only one image in set B.

Key Tools: Key Tools and Techniques for Performance Management. Performance management helps organisations become more successful and stay ahead of the competition. It essentially involves measuring, reporting and managing progress in order to improve performance, both at an individual level, and at a corporate level.

14.8. SELF-ASSESSMENT QUESTIONS

1.Discuss about the origin of Central Banking..
2. What is Central Bank? Explain the role of central Bank.
3. Discuss various functions of Reserve Bank of India..
4. What is the meaning of Subsidiaries? Given some examples of RBI Subsidiaries .
5. What is RBI? Explain different Key Tools used by RBI.

14.9. SUGGESTED READINGS

1. V.A.Avadhani, Marketing of Financial Services, Himalayas Publishers, Mumbai .
2. DK Murthy, and Venugopal, Indian Financial System, IK Int Pub House.
3. Anthony Saunders and MM Cornett, Fin Markets &Institutions,TMH.
4. Punithavathy Pandian, Financial Markets and Services, Vikas, New Delhi .

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LESSON-15
MONETARY & CREDIT POLICY OF RBI

AIMS AND OBJECTIVES

After studying this lesson, you should be able to:

- Know the meaning of monetary & credit policy.
- Understand the role of credit policy in the development of economy.
- Understand the application of financial instruments for the development of economy.

STRUCTURE

15.1 INTRODUCTION

Under the Reserve Bank of India, Act,1934 (RBI Act,1934) (as amended in 2016), RBI is entrusted with the responsibility of conducting monetary policy in India with the primary objective of maintaining price stability while keeping in mind the objective of growth.

15.1.1 Monetary policy frame work

In May 2016, the RBI Act, 1934 was amended to provide a statutory basis for the implementation of the flexible inflation targeting framework.

15.1.2 Inflation Target

Under Section 45ZA, the Central Government, in consultation with the RBI, determines the inflation target in terms of the Consumer Price Index (CPI), once in five years and notifies it in the Official Gazette. Accordingly, on August 5, 2016, the Central Government notified in the Official Gazette 4 per cent Consumer Price Index (CPI) inflation as the target for the period from August 5, 2016 to March 31, 2021 with the upper tolerance limit of 6 per cent and the lower tolerance limit of 2 per cent. On March 31, 2021, the Central Government retained the inflation target and the tolerance band for the next 5-year period – April 1, 2021 to March 31, 2026.

Section 45ZB of the RBI Act provides for the constitution of a six-member Monetary Policy Committee (MPC) to determine the policy rate required to achieve the inflation target.

15.1.3 Failure to Maintain Inflation Target

The Central Government has notified the following as the factors that constitute failure to achieve the inflation target: (a) the average inflation is more than the upper tolerance level of the inflation target for any three consecutive quarters; or (b) the average inflation is less than the lower tolerance level for any three consecutive quarters.

Where the Bank fails to meet the inflation target, it shall set out in a report to the Central Government:

- the reasons for failure to achieve the inflation target;
- remedial actions proposed to be taken by the Bank; and
- an estimate of the time-period within which the inflation target shall be achieved pursuant to timely implementation of proposed remedial actions.

The operating framework of monetary policy aims at aligning the operating target – the weighted average call rate (WACR) – with the policy repo rate through proactive liquidity management to facilitate transmission of repo rate changes through the entire financial system, which, in turn, influences aggregate demand – a key determinant of inflation and growth.

15.2 MONETARY POLICY COMMITTEE (MPC)

Section 45ZB of the amended RBI Act, 1934 provides for an empowered six-member monetary policy committee (MPC) to be constituted by the Central Government by notification in the Official Gazette. The first such MPC was constituted on September 29, 2016. The present MPC members, as notified by the Central Government in the Official Gazette of October 5, 2020, are as under:

1) Governor of the Reserve Bank of India—Chairperson, ex officio;
2) Deputy Governor of the Reserve Bank of India, in charge of Monetary Policy—Member, ex officio;
3) One officer of the Reserve Bank of India to be nominated by the Central Board—Member, ex officio;
4) Professor—Member;
5) Professor, Indian Institute of Management, Ahmedabad—Member; and
6) Senior Advisor, National Council of Applied Economic Research, Delhi—Member.

(Members referred to at 4 to 6 above, will hold office for a period of four years or until further orders, whichever is earlier)

- The MPC determines the policy repo rate required to achieve the inflation target.
- The MPC is required to meet at least four times in a year. The quorum for the meeting of the MPC is four members.
- Each member of the MPC has one vote, and in the event of an equality of votes, the Governor has a second or casting vote.
- Each Member of the Monetary Policy Committee writes a statement specifying the reasons for voting in favour of, or against the proposed resolution.

15.3 INSTRUMENTS OF MONETARY POLICY

There are several direct and indirect instruments that are used for implementing monetary policy.

- **15.3.1 Repo Rate:** The interest rate at which the Reserve Bank provides liquidity under the liquidity adjustment facility (LAF) to all LAF participants against the collateral of government and other approved securities.
- **15.3.2 Standing Deposit Facility (SDF) Rate:** The rate at which the Reserve Bank accepts uncollateralised deposits, on an overnight basis, from all LAF participants. The SDF is also a financial stability tool in addition to its role in liquidity management. The SDF rate is placed at 25 basis points below the policy repo rate. With introduction of SDF in April 2022, the SDF rate replaced the fixed reverse repo rate as the floor of the LAF corridor.
- **15.3.3 Marginal Standing Facility (MSF) Rate:** The penal rate at which banks can borrow, on an overnight basis, from the Reserve Bank by dipping into their Statutory Liquidity Ratio (SLR) portfolio up to a predefined limit (2 per cent). This provides a safety valve against unanticipated liquidity shocks to the banking system. The MSF rate is placed at 25 basis points above the policy repo rate.
- **15.3.4 Liquidity Adjustment Facility (LAF):** The LAF refers to the Reserve Bank's operations through which it injects/absorbs liquidity into/from the banking system. It consists of overnight as well as term repo/reverse repos (fixed as well as variable rates), SDF and MSF. Apart from LAF, instruments of liquidity management include outright open market operations (OMOs), forex swaps and market stabilisation scheme (MSS).
- **15.3.5 LAF Corridor:** The LAF corridor has the marginal standing facility (MSF) rate as its upper bound (ceiling) and the standing deposit facility (SDF) rate as the lower bound (floor), with the policy repo rate in the middle of the corridor.
- **15.3.6 Main Liquidity Management Tool:** A 14-day term repo/reverse repo auction operation at a variable rate conducted to coincide with the cash reserve ratio (CRR) maintenance cycle is the main liquidity management tool for managing frictional liquidity requirements.
- **15.3.7 Fine Tuning Operations:** The main liquidity operation is supported by fine-tuning operations, overnight and/or longer tenor, to tide over any unanticipated liquidity changes during the reserve maintenance period. In addition, the Reserve Bank conducts, if needed, longer-term variable rate repo/reverse repo auctions of more than 14 days.
- **15.3.8 Reverse Repo Rate:** The interest rate at which the Reserve Bank absorbs liquidity from banks against the collateral of eligible government securities under the LAF. Following the introduction of SDF, the fixed rate reverse repo operations will be at the discretion of the RBI for purposes specified from time to time.
- **15.3.9 Bank Rate:** The rate at which the Reserve Bank is ready to buy or rediscount bills of exchange or other commercial papers. The Bank Rate acts as the penal rate charged on banks for shortfalls in meeting their reserve requirements (cash reserve ratio and statutory liquidity ratio). The Bank Rate is published under Section 49 of the RBI Act, 1934. This rate has been aligned with the MSF rate and, changes automatically as and when the MSF rate changes alongside policy repo rate changes.
- **15.3.10 Cash Reserve Ratio (CRR):** The average daily balance that a bank is required to maintain with the Reserve Bank as a per cent of its net demand and time liabilities (NDTL) as on the last Friday of the second preceding fortnight that the Reserve Bank may notify from time to time in the Official Gazette.
- **15.3.11 Statutory Liquidity Ratio (SLR):** Every bank shall maintain in India assets, the value of which shall not be less than such percentage of the total of its demand and time liabilities in India as on the last Friday of the second preceding fortnight, as the Reserve Bank may, by notification in the Official Gazette, specify from time to time

and such assets shall be maintained as may be specified in such notification (typically in unencumbered government securities, cash and gold).

- **15.3.12 Open Market Operations (OMOs):** These include outright purchase/sale of government securities by the Reserve Bank for injection/absorption of durable liquidity in the banking system.

15.4 MONETARY POLICY PROCESS

The Reserve Bank has notified Reserve Bank of India Monetary Policy Committee and Monetary Policy Process Regulations, 2016 which came into effect from August 01, 2016. In terms of Regulation 5 of these regulations ibid., the Monetary Policy Process consists of the following:

a) Meeting schedule: The schedule of monetary policy voting/decision meetings for the entire fiscal year is announced in advance.

b) Meeting notice: Ordinarily, not less than fifteen days' notice is given to members for meetings of the Committee. Should it be found necessary to convene an emergency meeting, 24 hours' notice is given to every member to enable him/her to attend, with technology enabled arrangements for even shorter notice period for meetings.

c) Meeting duration: The duration of monetary policy meetings is as decided by the Committee. The policy resolution is publicly released after the conclusion of the MPC meeting keeping in view the functioning and timing of financial markets.The MPC reviews in detail the staff's macroeconomic projections, and alternative scenarios around various risks to the outlook.

d) The MPC Resolution: The Bank publishes, after the conclusion of every meeting of the MPC, the resolution adopted by the said Committee. The resolution includes the MPC's decision on the policy repo rate.

e) Minutes of the MPC meeting: On the 14th day after every meeting of the MPC, the minutes of the proceedings of the MPC are published which include: (a) the resolution adopted by the MPC; (b) the voting of each member on the resolution; and (c) short written statements of individual members justifying the vote, consistent with the provisions of Section 45ZL of the RBI Act. Minutes shall be released at 5 pm on the 14th day from the date of the policy day (or next earliest working day, if a holiday in Mumbai).

f) The Monetary Policy Report: Once in every six months, the Reserve Bank publishes the Monetary Policy Report containing the following elements:

- Explanation of inflation dynamics in the last six months and the near-term inflation outlook;
- Projections of inflation and growth and the balance of risks;
- An assessment of the state of the economy, covering the real economy, financial markets and stability, fiscal situation, and the external sector, which may entail a bearing on monetary policy decisions;
- An updated review of the operating procedure of monetary policy; and
- An assessment of projection performance.

15.5 MONETARY POLICY PROCESS REGULATIONS, 2016

15.5.1 Monetary Policy Process

(i) These regulations shall be called as the Reserve Bank of India Monetary Policy Committee and Monetary Policy Process Regulations, 2016.

(ii) They shall come into force effective from 1st August, 2016.

15.5.2 Interpretations: In these regulations:

a) "the Act" means the Reserve Bank of India Act, 1934 (2 of 1934);

b) "the Bank" means the Reserve Bank of India;

c) "the Board" means the Central Board of the Reserve Bank of India;

d) "Committee" means the Monetary Policy Committee (MPC) constituted under sub-section 1 of Section 45ZB of the Reserve Bank of India Act, 1934 (2 of 1934);

e) "Members" means members of the Monetary Policy Committee appointed by the Central Government under sub-section (2) of Section 45ZB of the Reserve Bank of India Act, 1934 (2 of 1934); f) "Secretary" means the secretary to the Monetary Policy Committee;

g) "Monetary Policy Report" means the Monetary Policy Report as mentioned in Section 45ZM of the Act;

h) other expressions used but not defined in these Regulations and used in the Act have the meanings respectively assigned to them in the Act.

15.5.3 Remuneration and other allowances payable to the members:

(i) Members appointed under clause (d) of sub-section (2) of section 45ZB of the Act shall receive a remuneration of Rs 1,50,000 (rupees one lakh fifty thousand) for devoting time and work for each meeting of the Committee to be conducted under sub-section (1) of section 45ZI of the Act which they attend and other expenses relating to air travel, local transportation and accommodation as may be decided by the Central Board from time to time.

(ii) The Secretary to the MPC shall make arrangements to provide logistical support to members appointed under clause (d) of sub-section (2) of section 45ZB of the Act during each MPC meeting to be conducted under sub-section (1) of section 45ZI of the Act.

15.5.4 Functions and manner in which the Secretary shall perform the functions:

(i) The head of the Monetary Policy Department (MPD) shall be the Secretary to the committee. In his/her absence, the representative nominated by him/her not below the rank of senior officer in MPD shall function as the Secretary.

(ii) Role and Functions of the Secretary and Secretariat

- ❖ Assist the MPC in smooth conduct of all its meetings, and ensure that the processes set out at regulation 5(i) below are followed in letter and spirit;
- ❖ Assist in preparing the agenda for every MPC meeting;
- ❖ Ensure that analytical and data requirements for MPC meetings and of members are met through an effective coordination mechanism involving staff across various departments of the Bank;
- ❖ Prepare (i) draft policy proposal (resolution and statement) for voting by the MPC; (ii) minutes/proceedings of MPC meetings; and (iii) ensure release of policy resolution and statement as well as minutes after the MPC's approval in accordance with the schedule;
- ❖ Record and preserve minutes of all meetings; and
- ❖ Assume responsibility for publication of documents.

15.6 PROCEDURE, CONDUCT, CODE OF CONFIDENTIALITY AND OTHER MATTERS

15.6.1 The Monetary Policy Process

(a) The schedule of monetary policy voting/decision meetings for the entire fiscal year shall be announced in advance.

(b) Ordinarily not less than fifteen days' notice shall be given to members for meetings of the Committee. Should it be found necessary to convene an emergency meeting, 24 hours' notice shall be given to every member to enable him/her to attend, with technologyenabled arrangements for even shorter notice period for meetings.

(c) The duration of monetary policy meetings shall be such as decided by the Committee. The policy resolution will be publicly released after the conclusion of the MPC meeting keeping in view the functioning and timing of financial markets.

(d) The resolution shall include the policy repo rate, and at the discretion of the Chairperson, any other monetary policy measures including those relating to the operating framework of monetary policy.

(e) Minutes of the decision-making meeting(s) shall include:

- ❖ the resolution adopted by the MPC;
- ❖ the voting of each member on the resolution; and
- ❖ short written statements of individual members justifying the vote, consistent with the provisions of Section 45ZL of the Act.

Minutes shall be released at 5 pm on the 14th day from the date of the policy day (or next earliest working day, if a holiday in Mumbai).

15.6.2 Code of Conduct for MPC Members:

This code aims at providing broad guidance to members of the MPC on their ethical conduct, which shall help enhance public trust and confidence in the Bank and its policies.

• MPC members shall act in a manner consistent with the integrity, dignity and reputation of their office.

• MPC members shall be guided by the objectives of monetary policy set out in the Act and the inflation target set by the Central Government, and shall independently and candidly express their views in the MPC meetings before voting.

• Members shall take adequate precaution to ensure utmost confidentiality of the MPC's policy decision before it is made public and preserve confidentiality about the decision-making process.

• While interacting with profit-making organizations or making personal financial decisions, they shall be mindful of, and weigh carefully, any scope for conflict between personal interest and public interest.

15.7 EXTERNAL COMMUNICATION POLICY

• Members shall observe a silent or blackout period, starting seven days before the voting/decision day, and ending seven days after the day policy is announced. During this period, they will avoid public comment on issues related to monetary policy, other than through the MPC's communication framework.

• Members shall ensure that personal views expressed outside the silent or blackout period are attributable only to themselves, and that no confidential information accessed during the monetary policy deliberations is revealed outside the Committee.

• Members shall not use resources made available by the Bank (including human resources) for private/ commercial gain.

15.7.1 Internal Communication and Information Seeking

Members seeking information from the Bank under sub-section (1) and sub-section (2) of section 45ZH of the Act shall make requests to the Secretary only. All internal communication of members with the staff of the Bank shall be through the Secretary only.

15.7.2 Code for Personal Financial Transactions

After their appointment, members shall disclose their assets and liabilities in a document held by the Secretary of the Committee. This information shall be updated once every year.

15.7.3 Code for High Ethical Standards

Members shall maintain the highest standards of probity consistent with public office.

15.7.4 Oath of Secrecy

Before the first formal meeting of the MPC, every new member shall sign a declaration in the form set out in the Schedule pledging not to reveal any of the non-public matters which may come to his/her knowledge in the discharge of his/her duties, except when required or authorised to do so by the Board or by law.

15.7.5 Others

The Chairperson of the Committee shall forthwith inform the Central Government, if and when it comes to the notice of the Committee, that a member has become subject to any of the disqualifications specified in section 45ZC or section 45ZE of the Act.

Every member shall be indemnified by the Bank against all losses and expenses incurred in discharging assigned duties, except such as may happen from his/her own wilful act or default.

Document 1 (The Bank shall publish a Document explaining the steps to be taken by it to implement the decisions of the Committee as required in Section 45ZJ of the Act.)

(i) The operating procedure of monetary policy - or the framework to implement monetary policy decisions – shall be reviewed and explained in the bi-annual Monetary Policy Reports (MPRs).

Monetary policy changes involving instruments other than the repo rate and the operating procedure as decided by the MPC shall be explained in the policy statement, followed by a press release setting out details on implementation.

Document (2) (The forms and contents of the Monetary Policy Report to be published under sub-section (2) of section 45ZM.)

The Bank shall publish the Monetary Policy Report (MPR) once in every six months.

15.7.6 The Monetary Policy Report shall contain the following:

(a) Explanation of inflation dynamics in the last six months and the near-term inflation outlook;

(b) Projections of inflation and growth and the balance of risks;

(c) An assessment of the state of the economy, covering the real economy, financial markets and stability, fiscal situation, and the external sector, which may entail a bearing on monetary policy decisions;

(d) An updated review of the operating procedure of monetary policy; and

(e) An assessment of projection performance.

15.7.7 Form of the MPR

The MPR shall be released on the Bank website within 24 hours of the release of the relevant policy statement.

15.7.8 Process to be followed in the event of a failure to meet the inflation target:

The Secretary to the Committee shall schedule a separate meeting as part of the normal policy process to discuss and draft the report to be sent to the Central Government under the provisions of Section 45ZN of the Act. The Report shall be sent to the Central Government within one month from the date on which the Bank has failed to meet the inflation target. The Bank shall send the report to the Central Government in the event of a failure to achieve the target as specified by Rules of the Central Government, in this regard.

15.8. SUMMARY

After studying this lesson, you should be able to: Know the meaning of monetary & credit policy. Understand the role of credit policy in the development of economy. Understand the application of financial instruments for the development of economy. Monitory Policy Committee (MPC). Instruments of Monetary Policy. Monetary Policy Process. Monetary Policy Process Regulations, 2016 Procedure, conduct, code of confidentiality and other matters. External Communication Policy. The Monetary Policy Committee (MPC) determines the policy repo rate required to achieve the inflation target. The MPC uses different instruments like Repo rate, Bank rate, Reverse repo rate, Statutory liquidity ratio, Cash reserve ratio etc. to cash flow in the economy. It uses these instruments to manage flow of funds, liquidity in the market and control inflation in economy.

15.9. TECHNICAL TERMS

Monetary Policy: Monetary policy is the policy adopted by the monetary authority of a nation to control either the interest rate payable for very short-term borrowing (borrowing by banks from each other to meet their short-term needs) or the money supply, often as an attempt to reduce inflation or the interest rate, to ensure price stability and general trust of the value and stability of the nation's currency.

A credit policy: A credit policy is a document outlining an organization's approach to extending money to customers. Credit policies typically include a set of principles for lending money, qualification requirements, and details regarding the collection of unpaid loans. Credit policies vary depending on the business.

Economy: An economy is a complex system of interrelated production, consumption, and exchange activities that ultimately determines how resources are allocated among all the participants. The production, consumption, and distribution of goods and services combine to fulfill the needs of those living and operating within the economy.

Regulations: Dictionary.com defines 'regulation' as: A law, rule, or other order prescribed by authority, especially to regulate conduct. The act of regulating or the state of being regulated. A governmental or ministerial order having the force of law. As required by official rules or procedure.

Com. Policy: Communication policies of an organization set expectations and manage the flow of communications within and outside the organization. They facilitate meaningful and necessary communication for employee productivity and morale without restricting communication. Having a good communication policy in place reduces conflicts and misunderstandings.

15.10. SELF-ASSESSMENT QUESTIONS

1. What is the meaning of monetary & credit policy?
2. What is the role of credit policy in the development of economy?
3. Explain the application of financial instruments for the development of economy & Monitory Policy Committee (MPC).
4. What is Monetary Policy Process? Explain the Instruments of Monetary Policy.
5. Briefly discuss Monetary Policy Process Regulations, 2016 Procedure, conduct, code of confidentiality and other matters.
6. What is External Communication Policy?
7. How the Monetary Policy Committee (MPC) determines the policy repo rate required to achieve the inflation target?

15.11. SUGGESTED READINGS

1. V.A.Avadhani, Marketing of Financial Services, Himalayas Publishers, Mumbai .
2. DK Murthy, and Venugopal, Indian Financial System, IK Int Pub House.
3. Anthony Saunders and MM Cornett, Fin Markets &Institutions,TMH.
4. Punithavathy Pandian, Financial Markets and Services, Vikas, New Delhi .

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LESSON-16
FINANCIAL MARKET & BANKING REFORMS

AIMS AND OBJECTIVES

After studying this lesson, you should be able to:

- Know the meaning of capital & money market
- Understand and operate different Money Market Instruments for short term finance
- Study different reforms made by RBI time to time
- Understand the role of NABARD in rural & agricultural development

STRUCTURE

16.1 INTRODUCTION

Financial market is a place or a system where financial assets or instruments are created and exchanged by market participants. One of the barometers to measure the economic health of a nation is to look at the efficiency of the financial market of the country. Financial markets play a significant role in performing the resource management in an economy through various financial assets namely equity, debt, currency and other quasi-instruments. Financial markets facilitate the price discovery and provide liquidity of financial assets. Financial market performs the crucial role of capital creation that is acting as a bridge between providers of finance and the seekers of finance.

The financial assets, also called financial claims or financial securities are issued by the seekers of finance. They issue the instruments to investors who have surplus money to invest. Between the two parties, there are financial intermediaries who act who act as conduits between the investors and issuers. Thus, there are four important elements of securities markets namely investors, issuers, intermediaries and regulators. The issuers can be government or corporate houses. The government issues gilt- edged securities whereas the corporate issue shares, debentures etc., depending on the time period for which the fund is required, and the financial instruments could be short term and long term. Depending on the participants, the financial markets are classified as primary and secondary market.

16.2 CAPITAL MARKETS

The capital market generally consists of the long-term financial instruments. The instruments used in the equity segment include equity shares, preference shares, convertible preference shares, non-convertible preference shares, etc; and in the debt segment include debentures, zero coupon bonds, deep discount bonds, etc. Section 85 of the Companies Act, 1956 permits public limited companies (having share capital) to have two kinds of shares namely - equity and preference. The various capital market instruments are explained below:

16.2.1 Equity share capital

An equity interest in a company may be said to represent a share of the company's assets and a share of any profits earned on those assets after other claims have been met. The equity shareholders are the owners of the business; they purchase shares, the money is used by the company to buy assets, the assets are used to earn profits, which belong to the ordinary shareholders. After satisfying the rights of preference shares, the equity shares shall be entitled to share in the remaining amount of distributable net profits of the company. The dividend on equity shares is not fixed and may vary from year to year depending upon the number of profits available. The rate of dividend is recommended by the Board of Directors of the company and declared by shareholders in the Annual General Meeting. Equity shareholders have a right to vote on every resolution placed in the meeting and the voting rights shall be in proportion to the paid-up capital. Equity capital can either be (i) With voting rights; or (ii) with differential rights as to dividend, voting or otherwise in accordance with such rules and subject to such conditions as may be prescribed.

16.2.2 Preference share capital

Preference share is a hybrid security because it has features of both ordinary shares and bonds. Preference shareholders have preferential rights in respect of assets and dividends. In the event of winding up the preference shareholders have a claim on available assets before the ordinary shareholders. In addition, preference shareholders get their stated dividend before equity shareholders can receive any dividends. The dividends on preference shares are fixed and they must be declared before a legal obligation exists to pay them. The fixed nature of dividend is similar to that of interest on debentures and bonds. The declaration feature is similar to that of equity shareholders dividends.

The general forms of preference shares are as follows:

- ➢ Cumulative and Non-cumulative Preference Shares: The cumulative preference share gives a right to demand the unpaid dividend of any year, during the subsequent years when the profits are ample.
- ➢ Cumulative Convertible Preference Shares: The cumulative convertible preference (CCP) share is an instrument that embraces features of both equity shares and preference shares, but which essentially is a preference share. The CCPs are convertible into equity shares at a future specified date at a predetermined conversion rate once it is converted into equity shares, it passes all the characteristics of an equity share.
- ➢ Participating and Non-participating Preference Shares: Participating preference shares are those shares which are entitled to a fixed preferential dividend and, in

addition, carry a right to participate in the surplus profits along with equity shareholders after dividend at a certain rate has been paid to equity shareholders.

➢ Redeemable and Irredeemable Preference Shares: Subject to an authority in the articles of association, a public limited company may issue redeemable preference shares to be redeemed either at a fixed date or after a certain period of time during the life time of the company. The Companies Act, 1956 prohibits the issue of any preference share which is irredeemable or is redeemable after the expiry of a period of twenty years from the date of issue.

16.2.3 Deferred/Founders Shares

A private company may issue deferred or founder's shares. Such shares are normally held by promoters and directors of the company. That is why they are usually called founders shares. These shares are usually of a smaller denomination, say one rupee each. However, they are generally given equal voting rights with equity shares which may be of higher denomination, say `10 each. Thus, by investing relatively lower amounts, the promoters may gain control over the management of the company. As regards the payment of dividends to holders of such shares, the articles usually provide that these shares will carry a dividend fixed in relation to the profits available after dividends have been declared on the preference and equity shares.

16.2.4 Sweat Equity Shares: Under section 79A of the Companies Act, 1956, a company can issue sweat equity shares to its employees or directors at discount or for consideration other than cash for providing knowhow or making available rights in the nature of intellectual property rights or value addition etc

16.3 INDIAN MONEY MARKETS

Money market means market where money or its equivalent can be traded. Money is synonym of liquidity. Money market consists of financial institutions and dealers in money or credit who wish to generate liquidity. It is better known as a place where large institutions and government manage their short-term cash needs. Money Market is part of financial market where instruments with high liquidity and very short-term maturities are traded. Hence, money market is a market where short-term obligations such as treasury bills, commercial papers and bankers' acceptances are bought and sold.

16.3.1 Structure of Money Market The structure of money market can be divided into two parts, viz., organized and unorganized. Organized structure includes…

- Reserve bank of India.
- DFHI (discount and finance house of India).
- Commercial banks (Public sector banks, SBI & its associates, Cooperative banks, Private sector banks and foreign banks)
- Development bank IDBI, IFCI, ICICI, NABARD, LIC, GIC, UTI etc. The unorganized structure include:
- Indigenous banks
- Money lenders
- Chits &Nidhis
- Co-operative Sector (State and central cooperative banks, Primary urban banks, Primary Agri. credit societies, State, Central and Primary Land development banks)

16.4 FUNCTIONS OF MONEY MARKET

The money market performs three broad functions.

- ❖ It provides an equilibrating mechanism for demand and supply of short-term funds.
- ❖ It enables borrowers and lenders of short-term funds to fulfil their borrowing and investment requirements at an efficient market clearing price.
- ❖ It provides an avenue for central bank intervention in influencing both quantum and cost of liquidity in the financial system, thereby transmitting monetary policy impulses to the real economy.

The objective of monetary management by the central bank is to align money market rates with the key policy rate. As excessive money market volatility could deliver confusing signals about the stance of monetary policy, it is critical to ensure orderly market behaviour, from the point of view of both monetary and financial stability. Thus, efficient functioning of the money market is important for the effectiveness of monetary policy.

16.5 FEATURES OF MONEY MARKET IN INDIA

1) It is a market purely for short-term funds or financial assets called near money.
2) It deals with financial assets having a maturity period less than one year only.
3) In Money Market, transaction transactions can be done through oral communication, relevant document and written communication.
4) Transactions have to be conducted without the help of brokers.
5) It is not single homogeneous market, it comprises of several sub market like call money market, acceptance bill market.
6) The players in the money market include commercial banks, acceptance houses and NBFC (Non-Banking Financial Companies).

16.6 IMPORTANCE OF MONEY MARKET

1) Development of trade and industry.
2) Development of capital market.
3) Smooth functioning of commercial banks.
4) Effective central bank control.
5) Formulation of suitable monetary policy.
6) Non-inflationary source of finance to government.

Composition of Money Market Money Market consists of a number of sub-markets which collectively constitute the money market. They are Call Money Market, Commercial Bills Market, Acceptance Market, and Treasury bill Market. Money Market Instruments Investment in money market is done through money market instruments. Money market instrument meets short term requirements of the borrowers and provides liquidity to the lenders.

16.7 MONEY MARKET INSTRUMENTS

Money Market Instruments are as follows:

- Treasury Bills (T-Bills)
- Central Government Securities (Gilt-edged Securities)
- State Government and Public Sector Instruments

- Municipal Bonds
- Commercial Papers
- Certificates of deposits
- Bills Rediscounting
- Call/Notice Money Market
- Repurchase Agreements (Repos)
- Inter Bank Participation
- Bank deposits
- Term Money
- Corporate Debentures and Bonds
- Bankers' Acceptance
- Commercial Bills
- Fringe Market

16.7.1 Treasury Bills (T-Bills) Treasury Bills, one of the safest money market instruments, are short-term borrowing instruments of the Central Government of the Country issued through the Central Bank (RBI in India). They are zero risk instruments, and hence the returns are not so attractive. It is available both in primary market as well as secondary market. It is a promise to pay a said sum after a specified period. T-bills are short-term securities that mature in one year or less from their issue date. They are issued with three-month, six-month and one-year maturity periods. The Central Government Issues T- Bills at a price less than their face value (par value). They are issued with a promise to pay full face value on maturity. So, when the T-Bills mature, the government pays the holder its face value. T-Bills are issued through a bidding process at auctions.

16.7.2 Repurchase Agreements Repurchase transactions, called Repo or Reverse Repo are transactions or short-term loans in which two parties agree to sell and repurchase the same security. They are usually used for overnight borrowing. Repo/Reverse Repo transactions can be done only between the parties approved by RBI and in RBI approved securities viz. GOI and State Government Securities, T-Bills, PSU Bonds, FI Bonds, Corporate Bonds etc.
Under repurchase agreement the seller sells specified securities with an agreement to repurchase the same at a mutually decided future date and price. Similarly, the buyer purchases the securities with an agreement to resell the same to the seller on an agreed date at a predetermined price. Such a transaction is called a Repo when viewed from the perspective of the seller of the securities and Reverse Repo when viewed from the perspective of the buyer of the securities. Thus, whether a given agreement is termed as a Repo or Reverse Repo depends on which party initiated the transaction.

16.7.3 Commercial Papers Commercial paper is a low-cost alternative to bank loans. It is a short term unsecured promissory note issued by corporate and financial institutions at a discounted value on face value. They are usually issued with fixed maturity between 1 to 270 days and for financing of accounts receivables, inventories and meeting short term liabilities. Commercial paper being an instrument not backed by any collateral, only firms with high quality credit ratings will find buyers easily without offering any substantial discounts.

16.7.4Certificate of Deposit It is a short-term borrowing more like a bank term deposit account. It is a promissory note issued by a bank in form of a certificate entitling the bearer to receive interest. The certificate bears the maturity date, the fixed rate of interest and the value. It can be issued in any denomination. They are stamped and transferred by endorsement. Its term generally ranges from three months to five years and restricts the holders to withdraw funds on demand. However, on payment of certain penalty the money can be withdrawn on demand also.

16.7.5 Bankers' Acceptance It is a short-term credit investment created by a non-financial firm and guaranteed by a bank to make payment. It is simply a bill of exchange drawn by a person and accepted by a bank. It is a buyer's promise to pay to the seller a certain specified amount at certain date. The same is guaranteed by the banker of the buyer in exchange for a claim on the goods as collateral. The person drawing the bill must have a good credit rating otherwise the Banker's Acceptance will not be tradable. The most common term for these instruments is 90 days. However, they can vary from 30 days to180 days. For corporations, it acts as a negotiable time draft for financing imports, exports and other transactions in goods and is highly useful when the credit worthiness of the foreign trade party is unknown. The seller need not hold it until maturity and can sell off the same in secondary market at discount from the face value to liquidate its receivables.

16.7.6 Commercial Bills Purchase and discounting of commercial bills is a way by which banks provide funds for working capital required by commerce, trade and industry. The financial instrument trading in the bills market is the bill of exchange. It is a written instrument containing unconditional order signed by the maker, directing to pay a certain amount of money to a particular person, or to the bearer of the instrument. It is a negotiable self-liquidating instrument with low degree of risk. Its liquidity is exceeded only by T-bills, call loans and cash, in that order.

16.7.7 Term Money RBI has permitted some of the Financial Institutions like IDBI, ICICI, IFCI, HBI, SIDBI, NABARD, EXIM-Bank etc. to borrow from the market for a period of 3 months and up to a period of not more than 6 months within the stipulated limits. The rate of interest on the term money is determined between the parties by mutual negotiation. The investment in term money is unsecured and the limits are fixed by RBI. The term money is accepted by their institutions at a discounted value. On the due date the payment will be equal to the face value of the instrument, which for all purpose consists of term deposit receipt.

16.7.8 Bank Deposits The banks are permitted to keep deposits with other banks for a period of 15 days and above. The rate of interest of such deposits is freely determined by the two banks between themselves through negotiations. Like the call/notice money transactions, the transactions relating to the bank deposit is evidenced by way of deposit receipt. These deposits are not transferable, but they could be prematurely closed at the discretion of the lender.

16.7.9 Bankers' Acceptance A banker's acceptance is a draft against a bank ordering the bank to pay some specified amount at a future date. The banker's acceptance is very safe security and is used as a money market instrument.

16.7.10 Fringe Market The fringe market is a disorganized money market, deemed to include everything that is outside the scope of the money market (i.e., the institutional money market). The fringe market includes activities like the Inter-Corporate Deposit (ICD) market, small scale trade financing, financing of investments in the stock market, discounting and lending against promissory notes, etc. Generally, the fringe market exist, wherever the main borrowers and lenders of the funds are based, i.e., at the location of the industrial, corporate and trading establishments.

16.7.11 Call Money Market Call money refers to that transaction which is received or delivered by the participants in the call money market and where the funds are returnable next day. The call money transactions are also referred to as overnight funds. Notice money on the other hand is a transaction where the participants will take time to receive or deliver for more than two days but generally for a maximum of fourteen days.

Hybrid Market and Instruments

Hybrid instruments have both the features of equity and debenture. This kind of instruments is called as hybrid instruments. Examples are convertible debentures, warrants etc.

16.8 BANKING REFORMS IN INDIA

One of the objectives of nationalisation of the banks in 1969 was to extend the reach of organised banking services to rural areas and to the neglected sections/sectors of society. Since 1969, there has been a significant spread of the banking habit and a large mobilisation of savings by banks.

Banking system also played a major role in widening the entrepreneurial base of the country. However, by 'eighties, it was clear that the operational efficiency was unsatisfactory. Banks were characterised by low profitability with high and growing nonperforming assets.

There was a problem of low capital base and also a belief that with Government ownership, there was little to worry about a low capital base. More important, the lack of proper disclosure norms led to many problems being kept under cover. Poor internal controls raised serious doubts about the integrity of the system itself. The quality of customer service did not keep pace with increasing expectations. In fact, there was a feeling that the inefficiency of the banking system was encouraging diversion of domestic financial savings away from banks.

No doubt, a series of reform measures were undertaken since 1985 but the first phase of comprehensive reforms in the banking sector can be traced to the 1991 Report of the Committee on the Financial System, i.e., Narasimham Committee I. These reforms were undertaken in parallel with, and as an important element of the overall economic reforms of the 'nineties.

The major features of this phase of reforms can be summarised in the words of my predecessor, Dr. S. S. Tarapore:

- ❖ First, the fiscal undertook to restrict its demand for monetisation of its deficit and a concerted effort was made to move to market related rates of interest.
- ❖ Secondly, the pre-emptions by way of the cash reserve ratio and the statutory liquidity ratio were reduced.
- ❖ Thirdly, there was a total freeing of deposit and lending rates with only very limited controls (loans up to Rs.2 lakh, export credit and savings bank interest).
- ❖ Fourthly, following the Basle Committee standards, prudential norms were prescribed for capital adequacy, income recognition and provisioning.
- ❖ Fifthly, the banks were required to observe stricter disclosure norms.
- ❖ Sixthly, the regulatory/supervisory system was strengthened by the setting up of a Board for Financial Supervision.
- ❖ Lastly, institutional strengthening was undertaken to ensure the progressive development and integration of the securities, money and forex markets.

16.9 NABARD

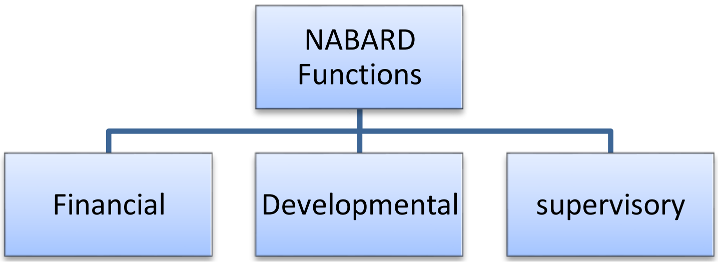
The importance of institutional credit in boosting rural economy has been clear to the Government of India right from its early stages of planning. Therefore, the Reserve Bank of India (RBI) at the instance of the Government of India, constituted a committee to Review the Arrangements for Institutional Credit for Agriculture and Rural Development (CRAFICARD) to look into these very critical aspects. The Committee was formed on 30 March 1979, under the Chairmanship of Shri B. Sivaraman, former Member of Planning Commission, Government of India.

The Committee's interim report, submitted on 28 November 1979, outlined the need for a new organisational device for providing undivided attention, forceful direction and pointed focus to credit related issues linked with rural development. Its recommendation was formation of a unique development financial institution which would address these aspirations and creation of National Bank for Agriculture and Rural Development (NABARD) was approved by the Parliament through Act 61 of 1981.
NABARD came into existence on 12 July 1982 by transferring the agricultural credit functions of RBI and refinance functions of the then Agricultural Refinance and Development Corporation (ARDC). It was dedicated to the service of the nation by the late Prime Minister Smt. Indira Gandhi on 05 November 1982. Set up with an initial capital of Rs.100 crore, its' paid-up capital stood at Rs.17,080 crore as on 31 March 2022. Consequent to the revision in the composition of share capital between Government of India and RBI, NABARD today is fully owned by Government of India.

1. Financial Functions:

NABARD performs the following functions under this section:

- Rural Infrastructure Development Fund:
- GOI created the RIDF in 1995-96 with an initial corpus of Rs. 2000 crore.
- There are 37 eligible activities under RIDF which can be classified under three categories:
- Agriculture and related sector
- Social sector
- Rural connectivity



- **Micro Irrigation Fund:**
  - NABARD started MIF form 2019-10 with a corpus of Rs. 5000 crore.
  - The objective of the MIF is to provide additional resources for the expansion of micro-irrigation practices.
- Provide loans for the development of Food Parks and Food Processing Units in Designated Food Parks.
- Provide loan to Warehouses, Cold Storage and Cold Chain Infrastructure for the development of storage infrastructure in India.
- Provide Credit Facilities to Marketing Federations and cooperatives to create value/supply chain management of the various agricultural commodities.
- Provided Direct Refinance facility to Cooperative Banks.

2. Development Functions:

NABARD plays a major role in the development of the rural region of our country. It performs the following function:

Institutional Development: NABARD is responsible for regulating and supervising the functions of Cooperative banks and RRBs which disburse more than 50% of the rural credit in India.

Some of the Institutional Development Initiatives of NABARD are:

- Developing policies in consultation with GOI & RBI related to strengthening Rural Cooperatives & RRBs.
- NABARD designed and maintains a web-based portal "ENSURE" to review the performance of Cooperative Banks.
- Track and record the financial status of Cooperative Bank & RRBs.
- Drafts policies related to business, auditors related and staff related matters of RRBs, also appoint Chairman of RRB.
- The appointment of NABARD Officer as Nominee Director in the Board of RRB is done by NABARD.

Other Development functions of NABARD:

- Provided credit assistant to the farm sector as well as allied economic activities of the rural region.
- performs various activities to promote the financial inclusion of the rural society of India.
- Through its' **Micro Credit Innovations Department, NABARD** has sustained its function as the facilitator and mentor of microfinance initiatives in the rural sector.
- **Research and Development (R&D) Fund** was established under the **NABARD Act 1981** to gain new insights into the difficulties of agricultural and rural development through in-depth studies and applied research.
- NABARD has constituted the **Environment and Social Policy of NABARD** to eradicate or minimize unnecessary environmental and social harm and to promote sustainable development.

3. Supervision Functions:

Section 35(6) of the Banking Regulation Act, 1949, empowers NABARD to conduct inspection of……

- ❖ State Cooperative Banks (StCBs).
- ❖ District Central Cooperative Banks (DCCBs) and
- ❖ Regional Rural Banks (RRBs).

In addition, NABARD has also been conducting periodic inspections of state level cooperative institutions such as State Cooperative Agriculture and Rural Development Banks (SCARDBs), Apex Weavers Societies, Marketing Federations etc., on a voluntary basis.

Objectives of Supervision

- To protect the interest of present and future depositors
- To ensure that the business conducted by these banks is in conformity with the Provisions of the relevant Acts/Rules, regulations/Bye-Laws

- To ensure observance of rules, guidelines, etc., formulated and issued by NABARD/RBI/Government
- To examine the financial soundness of the banks and
- To suggest ways and means for strengthening the institutions so as to enable them to play a more efficient role in purveying rural credit

16.10 SUMMARY

The financial markets play a significant role in the development of economy. Capital market instruments viz., Equity, Preference, Bonds and Debentures provide finance for long term requirement and Money market instruments like T-Bills, Certificate of deposits, commercial papers provide finance for short term requirements. RBI, the regulatory conducts time to time evaluation of capital markets, money markets and financial institutions. It offers amendments to the fiscal policies for the benefit of depositors, minimize uncertainty and to overcome the operational challenges. There are specialized banks which are meant for particular category. NABARD, is one which is meant for the promotion, marketing of agricultural products and development of agriculture in India. It offers various schemes to develop agriculture.

16.11 TECHNICAL TERMS

Regulatory,
Financial Markets,
Monetary Planning Committee,
Capital market,
Monetary Market,
NABARD

16.12. SELF ASSEMENT QUESTIONS

1. Discuss the functions of Reserve Bank of India?
2. Briefly discuss the role of capital market and money market?
3. What is money market? Explain money market instruments?
4. What is the role financial market in the development of economy?
5. Discuss the Banking sector reforms?
6. What are the different instruments used by Monetary Policy Committee? Explain?
7. Discuss the features & Importance of Money Market?
8. What is capital market? Discuss the components of capital market?
9. Discuss the steps in Monetary Planning policy?
10. Explain the role & functions of NABARD?

16.13 SUGGESTED READINGS

1. V.A.Avadhani, Marketing of Financial Services, Himalayas Publishers, Mumbai .
2. DK Murthy, and Venugopal, Indian Financial System, IK Int Pub House.
3. Anthony Saunders and MM Cornett, Fin Markets &Institutions,TMH.
4. Punithavathy Pandian, Financial Markets and Services, Vikas, New Delhi .

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LESSON- 17
INTERNATIONAL FINANCIAL INSTITUTIONS

AIMS AND OBJECTIVES

After reading this lesson, you should be able to-

- Reveal about the objectives & Functions of the international financial institutions.
- Explain the Sources of Finance & Classification of the main MDBs
- Know about several multilateral financial institutions (MFIs).
- Awareness about Bilateral Development Banks And Agencies

STRUCTURE

17.1. INTRODUCTION

An **international financial institution** (**IFI**) is a financial institution that has been established by more than one country, and hence is subject to international law. Its owners or share holders are generally national governments, although other international institutions and other organizations. To assesses the capacity of the international financial institutions the World Bank, International Monetary Fund, and regional development banks to respond effectively in the planning and implementation of the civilian components of post conflict reconstruction and peace building. The most prominent IFIs are creations of multiple nations, although some bilateral financial institutions exist and are technically IFIs. The best known IFIs were established after World War II to assist in the reconstruction of Europe and provide mechanisms for international cooperation in managing the global financial system.

At the Bretton Woods Conference in 1944 it was decided to establish a new monetary order that would expand international trade, promote international capital flows and contribute to monetary stability. The IMF and the World Bank were borne out of this Conference of the end of World War II. The World Bank was established to help the restoration of economies disrupted by War by facilitating the investment of capital for productive purposes and to promote the long-range balanced growth of international trade. On the other hand, the IMF is primarily a supervisory institution for coordinating the efforts of member countries to achieve greater cooperation in the formulation of economic policies. It helps to promote exchange stability and orderly exchange relations among its member countries. It is in this context that the present chapter reviews the purpose and working of some of the international financial institutions and the contributions made by them in promoting economic and social progress in developing countries by helping raise standards of living and productivity to the point of which development becomes self-sustaining.

Business Approaches: You should consider IFI-funded business opportunities as just one element of your larger international marketing strategy, rather than an entry point into a new market. That said, if you have already exported successfully to a particular market, you can expect that your strategy would adapt well to IFI project opportunities there. All IFIs assign project officers to each project and these individuals serve as the managers and supervisors who implement the project on behalf of the IFI. They are key contacts for seeking opportunities, and they will be much more interested in your company if you can offer them expertise or technologies that will help them solve problems and contribute to their projects' success.

As soon as you identify a project, you should review the project documents to identify the key decision makers and contact them to express your interest in participating. Visits to the borrowing country are essential for consulting and engineering firms, and can be very fruitful for exporters of goods and equipment as well. Whether you are meeting with IFI staff or with representatives of the executing agency, be well prepared and have specific topics to discuss; making general inquiries about business opportunities or asking for readily available information will be seen as a waste of time. You should be prepared to clearly demonstrate what you or your company can do to help the project officers advance their project, and provide appropriate information about your experience, capabilities and the solutions you intend to propose.

Working with a local partner is usually advisable. Such partnerships can give you the local presence and expertise that will help with any necessary follow-up and having someone on the spot may help you reduce costs. In most cases, moreover, local content is one of the evaluation criteria for a contract, and demonstrating that your bid has such content can make the difference between winning and losing a contract. Some of the subscription services that provide procurement notices also provide databases of local firms interested in IFI projects. There are also opportunities to participate in IFI-funded projects by subcontracting with prime contractors that have been awarded contracts in a project. Subcontracts are not governed by IFI procurement regulations and interested firms should contact prime contractors directly.

17.2. FUNCTIONS OF INTERNATIONAL FINANCIAL INSTITUTIONS

The Fund is to perform various functions to realise the above-mentioned objectives. Some of its major functions and activities are:

(a) Exchange Stability: The Fund is required to promote stability in the foreign exchange rates of its member countries. The Fund Agreement seeks to attain the exchange stability by requiring members to agree with the Fund suitable gold or dollar (U.S.) par values (connection with gold severed in January 196) for their respective currencies, so as to create a

system of stable exchange rates. Each member of the Fund undertakes to establish and maintain the agreed par value for its currency, and to consult the Fund on any change in excess of 10% of the initial party. The Fund allows such alterations in exchange rates only for correcting fundamental disequilibrium in the balance of payments of the country concerned. But, now exchange values are no longer (since January 196) determined in terms of gold, and so the IMF has ceased to have any direct impact on exchange values.
(b) Multinational Convertibility of Currencies: The Fund makes arrangement for the multinational convertibility of the currencies of the member countries within the prescribed limits of the quota of each member. Since the Fund contains the currencies of all member countries, a member is entitled to purchase whichever currency it needs. A member country can purchase foreign currencies every year up to 25% of its quota subject to the maximum limit of 200% of its quota. Thus, the Fund offers facilities to its members for additional liquidity.
(c) Assistance for Short-Term Payments Difficulties: The Fund makes its foreign exchange resources available, under proper safeguards, to its members to meet short-term or medium-term payments difficulties.
(d) Promotion of International Trade: The Fund seeks to promote international trade by inducing member nations to avoid restrictive currency practices and barriers to trade, such as multiple exchange rates, exchange control, etc. The countries retaining exchange controls are required to justify them.
(e) Allocation of Special Drawing Rights: The Fund also supplements, as and when needed, the existing reserve assets of the participants in the Special Drawing Account. It also makes allocation from the Account to the member countries.
(f) Other Functions: Its other functions include international monetary reform, recycling of petro-dollars to the oil-importing countries, etc. Recently, the Fund has to introduce a series of measures like the sale of its gold reserve delinking of the par values of currency from gold, etc. for increasing the supply of international liquidity and promoting greater monetary co-operation among member countries.

17.3. INTERNATIONAL SOURCES OF FINANCE

One major source of financing is international non-profit agencies. There are several regional development banks such as the Asian Development Bank, The African Development Bank and Fund and the Caribbean Development Bank. The primary purpose of these agencies is to finance productive development projects or to promote economic development in a particular region. The Inter-American Development Bank, for example, has the principal purpose of accelerating the economic development of its Latin American member countries. In general, both public and private entities are eligible to borrow money from such agencies as long as private funds are not available at reasonable rates and terms. Although the interest rate can vary from agency to agency, these loan rates are very attractive and very much in demand of all the international financial organisations, the most familiar is the World Bank, formally known as the International Bank for Reconstruction and Development (IBRD). The World Bank has two affiliates that are legally and financially distinct entities, the International Development Association (IDA) and the International Finance Corporation (IFC). Exhibit 1 provides a comparison among IBRD, IDA and IFC in terms of their objectives, member countries, lending terms, lending qualifications as well as other details. All three organisations have the same central goals: to promote economic and social progress in poor or developing countries by helping raise standards of living and productivity to the point at which development becomes self-sustaining.

Toward this common objective, the World Bank, IDA and IFC have three interrelated functions and these are to lend funds, to provide advice and to serve as a catalyst in order to stimulate investments by others. In the process, financial resources are channeled from developed countries to the developing world with the hope that developing countries, through this assistance, will progress to a level that will permit them, in turn, to contribute to the development process of other less fortunate countries. japan is a prime example of a country that has come full circle. From being a borrower, Japan is now a major lender to these three organisations. South Korea is moving in a direction similar to that of Japan nearly a quarter of a century ago.

17.4. INTERNATIONAL FINANCIAL INSTITUTIONS

An **international financial institution** (**IFI**) is a financial institution that has been established (or chartered) by more than one country, and hence is subject to international law. Its owners or shareholders are generally national governments, although other international institutions and other organizations occasionally figure as shareholders. The most prominent IFIs are creations of multiple nations, although some bilateral financial institutions (created by two countries) exist and are technically IFIs. The best known IFIs were established after World War II to assist in the reconstruction of Europe and provide mechanisms for international cooperation in managing the global financial system.

17.4.1.A Multilateral Development Bank (**MDB**): A multilateral development bank (MDB) is a development bank, created by a group of countries, that provides financing and professional advice to enhance development. An MDB has many members, including developed donor countries and developing borrower countries. MDBs finance projects through long-term loans at market rates, very-long-term loans below market rates (also known as credits), and grants.

The following are usually classified as the main MDBs:

- World Bank
- European Investment Bank (EIB)
- Islamic Development Bank (IsDB)
- Asian Development Bank (ADB)
- European Bank for Reconstruction and Development (EBRD)
- CAF - Development Bank of Latin America (CAF)
- Inter-American Development Bank Group (IDB, IADB)
- African Development Bank (AfDB)
- New Development Bank (NDB)
- Asian Infrastructure Investment Bank (AIIB)
- Arab Petroleum Investments Corporation (APICORP)
- Eastern and Southern African Trade and Development Bank (TDB)

17.4.2. "Sub-Regional" Multilateral Development Banks

There are also several "sub-regional" multilateral development banks. Their membership typically includes only borrowing nations. The banks lend to their members, borrowing from the international capital markets. Because there is effectively shared responsibility for repayment, the banks can often borrow more cheaply than could any one member nation. These banks include:

- Caribbean Development Bank (CDB)
- Central American Bank for Economic Integration (CABEI)

- East African Development Bank (EADB)
- West African Development Bank (BOAD)
- Black Sea Trade and Development Bank (BSTDB)
- Economic Cooperation Organization Trade and Development Bank (ETDB)
- Eurasian Development Bank (EDB)
- North American Development Bank (Nadbank)

17.4.3. Multilateral Financial Institutions (MFIS):
There are also several multilateral financial institutions (MFIs). MFIs are similar to MDBs but they are sometimes separated since they have more limited memberships and often focus on financing certain types of projects.

- European Commission (EC)
- International Finance Facility for Immunisation (IFFIm)
- International Fund for Agricultural Development (IFAD)
- Nordic Investment Bank (NIB)
- OPEC Fund for International Development
- Nederlandse Financieringsmaatschappij voor Ontwikkelingslanden NV (FMO)
- International Bank for Economic Co-operation (IBEC)
- International Investment Bank (IIB)
- Arab Bank for Economic Development in Africa (BADEA)

Bretton Woods institutions: The best-known IFIs were established after World War II to assist in the reconstruction of Europe and provide mechanisms for international cooperation in managing the global financial system. They include the World Bank, the IMF, and the International Finance Corporation. Today the largest IFI in the world is the European Investment Bank which lent 61 billion euros to global projects in 2011.

17.5. REGIONAL DEVELOPMENT BANKS

The regional development banks consist of several regional institutions that have functions similar to the World Bank group's activities, but with particular focus on a specific region. Shareholders usually consist of the regional countries plus the major donor countries. The best-known of these regional banks cover regions that roughly correspond to United Nations regional groupings, including the Inter-American Development Bank, the Asian Development Bank; the African Development Bank; the Central American Bank for Economic Integration; and the European Bank for Reconstruction and Development. The Islamic Development Bank is among the leading multilateral development banks. IsDB is the only multilateral development bank after the World Bank that is global in terms of its membership. 56 member countries of IsDB are spread over Asia, Africa, Europe and Latin America.

Founded	Name	Notes	HQ
1959	IDB Interamerican Development Bank http://www.IADB.org	Works in the Americas, but primarily for development in Latin America and the Caribbean	Washington
1960	CABEI Central American Bank for Economic Integration	Central America http://www.cabei.org	Tegucigalpa

1964	AfDB African Development Bank	Africa http://www.afdb.org	Abidjan
1973	IsDB Islamic Development Bank Group http://www.isdb.org	56 countries in Asia, Africa, Europe, and Latin America	Jeddah
1966	ADB Asian Development Bank	Asia http://www.adb.org	Manila
1970	CAF Development Bank of Latin America	Latin America http://www.caf.com	Caracas
29/5/91	EBRD European Bank for Reconstruction and Development	http://www.ebrd.com	London
16/4/56	CEB Council of Europe Development Bank	Coordinated organisation http://www.coebank.org	Paris
14/11/73	BOAD Banque ouest-africaine de développement West African Development Bank http://www.boad.org	Union économique et monétaire ouest-africaine, Cf.BCEAO Banque centrale des États de l'Afrique de l'Ouest	Lomé
1975	BDEAC Banque de developpement des États de l'Afrique centrale, Development Bank of Central African States http://www.bdeac.org	Communauté économique et monétaire de l'Afrique centrale (CEMAC). Not to be confused with BEAC Banque des États de l'Afrique centrale	Brazzaville, Congo

17.6. BILATERAL DEVELOPMENT BANKS AND AGENCIES

A bilateral development bank is a financial institution set up by one individual country to finance development projects in a developing country and its emerging market, hence the term bilateral, as opposed to multilateral. Examples include:

i. The Netherlands Development Finance Company FMO,[1] headquarters in The Hague; one of the largest bilateral development banks worldwide.\
ii. The DEG German Investment Corporation or Deutsche Investitions- und Entwicklungsgesellschaft,[2] headquartered in Cologne, Germany.
iii. The French Development Agency,[3] and Caisse des dépôts, founded 1816, both headquartered in Paris, France.
iv. The CDC Group,[4] is a development finance institution owned by the UK Government headquartered in London.

Other regional financial institutions: Financial institutions of neighboring countries established themselves internationally to pursue and finance activities in areas of mutual interest; most of them are central banks, followed by development and investment banks. The table below lists some of them in chronological order of when they were founded or listed as functioning as a legal entity. Some institutions were conceived and started working informally 2 decades before their legal inception (e.g. the South East Asian Central Banks Centre)

Founded	Name	Notes	HQ
17/5/1930	BIS Bank for International Settlements http://www.bis.org	The bank of all central banks, 60 members	Basle, Basel, Bâle
1958	EIB European Investment Bank http://www.eib.org	[*permanent dead link*] Created by European Union member states to provide long-term finance, mainly in the EU	Luxembourg
2/15/1965	AACB African Association of Central Banks, ABCA Association des Banques Centrales Africaines	Consists of 40 African central banks http://www.aacb.org/	Dakar, Senegal.
10/7/1970	IIB International Investment Bank http://www.iib.int	Consists of 9 member countries from 3 continents	Moscow, Russia
1974	ACU Asian Clearing Union	9 Central Banks https://www.asianclearingunion.org/	
8/1976	NIB NordicInvestment Bank[5] http://www.nib.int	Lending operations in its 8 member countries and emerging markets on all continents.[6]	Helsinki, Finland
3/2/1982	SEACEN South East Asian Central Banks Centre	19 Asian central banks http://www.seacen.org	Kuala Lumpur, Malaysia
24/1/1997	BSTDB Black Sea Trade and Development Bank http://www.bstdb.org	11member countries,corresponding to the Organization of the Black Sea Economic Cooperation	Thessaloniki, Greece
1998	ECB European Central Bank http://www.ecb.int	Central bank of 18 EU countries that have adopted the euro	Frankfurt am Main

17.7. LIST OF LARGEST FINANCIAL SERVICES COMPANIES BY REVENUE

The following is a list of the world's largest publicly traded financial services companies, ordered by annual sales for the latest Fiscal Year in millions of U.S. dollars according to the Fortune Global 500. (Currently the top 50 public companies are included, while privately held companies are not included). 2021

Rank	Company	Industry	Revenue (USD millions)	Net Income (USD millions)	Total Assets (USD billions)	Headquarters
1	Transamerica Corporation	Conglomerate	245,510	42,521	873	United States
2	Ping An Insurance Group	Insurance	191,509	20,738	1,460	China
3	ICBC	Banking	182,794	45,783	5,110	China
4	China Construction Bank	Banking	172,000	39,282	4,311	China
5	Agricultural Bank of China	Banking	153,884	31,293	4,169	China
6	China Life Insurance	Insurance	144,589	4,648	776	China
7	Allianz	Insurance	136,173	7,756	1,297	Germany
8	Bank of China	Banking	134,045	27,952	3,739	China
9	JP Morgan Chase	Banking	129,503	29,131	3,386	United States
10	AXA	Insurance	128,011	3,605	984	France
11	Fannie Mae	Investment Services	106,437	11,805	3,985	United States
12	Generali Group	Insurance	97,128	1,987	667	Italy
13	Bank of America	Banking	93,753	17,894	2,819	United States
14	Citigroup	Banking	88,839	11,047	2,260	United States
15	People's Insurance Company	Insurance	84,290	2,903	192	China
16	Crédit Agricole	Banking	82,958	3,067	2,399	France
17	BNP Paribas	Banking	81,632	8,052	3,045	France
18	HSBC	Banking	80,429	5,229	2,984	United

Rank	Company	Industry	Revenue (USD millions)	Net Income (USD millions)	Total Assets (USD billions)	Headquarters
						Kingdom
19	Wells Fargo	Banking	80,303	3,301	1,955	United States
20	State Farm	Insurance	78,898	3,738	299	United States
21	Nippon Life	Insurance	76,984	3,127	773	Japan
22	Munich Re	Insurance	74,074	1,379	364	Germany
23	Dai-ichi Life	Insurance	73,841	3,431	574	Japan
24	Banco Santander	Banking	73,630		1,845	Spain
25	MetLife	Insurance	67,842	5,407	795	United States
26	Bank of Communications	Banking	67,605	11,409	1,639	China
27	Freddie Mac	Investment Services	66,228	7,326	2,627	United States
28	Legal & General Group	Insurance	63,324	2,061	779	United Kingdom
29	Brookfield Asset Management	Investment Services	62,752		343	United States
30	Aviva	Insurance	62,579	3,588	655	United Kingdom
31	China Pacific Insurance	Insurance	61,185	3,562	271	China
32	China Merchants Bank	Banking	60,433	14,107	1,281	China
33	Zurich Insurance Group	Insurance	59,001	3,834	439	Switzerland
34	Manulife Financial	Insurance	58,840	4,377	691	Canada
35	Aegon	Insurance	58,221		543	Netherlands
36	Prudential	Insurance	57,033		940	United

Rank	Company	Industry	Revenue (USD millions)	Net Income (USD millions)	Total Assets (USD billions)	Headquarters
	Financial					States
37	Mitsubishi UFJ Financial Group	Banking	56,838	7,329	3,250	Japan
38	Prudential	Insurance	55,973	2,118	516	United Kingdom
39	StoneX Group Inc.	Investment Services	54,139	169	13	United States
40	Goldman Sachs	Investment Services	53,498	9,459	1,163	United States
41	Industrial Bank	Banking	53,313	9,655	1,209	China
42	Shanghai Pudong Development	Banking	52,628	8,443	1,219	China
43	Société Générale	Banking	52,068		1,789	France
44	Morgan Stanley	Investment Services	52,047	10,996	1,115	United States
45	State Bank of India	Banking	51,919	3,018	662	India
46	Tokio Marine Holdings	Insurance	51,516	1,526	232	Japan
47	AIA Group	Insurance	50,359	5,779	326	China
48	China Minsheng Banking	Banking	49,076	4,972	1,065	China
49	Power Corporation of Canada	Insurance	48,183	1,525	493	Canada
50	Talanx	Insurance	46,788	766	221	Germany
51	Lloyds Banking Group	Banking	14,592	1,882	1,183	United Kingdom

2018: The following is a list of the world's largest publicly traded financial services companies, ordered by annual sales for the latest Fiscal Year that ended March 31, 2018 or prior (all public companies with sales of $20 billion or more are included, while privately held companies are not included).

Rank	Company	Industry	Revenue (USD millions)	Net Income (USD millions)	Headquarters
1	Berkshire Hathaway	Conglomerate	247,500	4,020	United States
2	Ping An Insurance Group	Insurance	163,597	16,237	China
3	Allianz	Insurance	143,860	8,490	Germany
4	AXA	Insurance	113,130	2,310	France
5	JP Morgan Chase	Banking	105,486	30,709	United States
6	ICBC	Banking	105,400	44,260	China
7	China Construction Bank	Banking	94,987	37,200	China
8	China Life Insurance	Insurance	92,710	22,040	China
9	Bank of America	Banking	91,240	28,140	United States
10	Agricultural Bank of China	Banking	87,600	29,500	China
11	Wells Fargo	Banking	86,410	22,390	United States
12	HSBC	Banking	86,131	15,020	United Kingdom
13	Generali Group	Insurance	75,460	2,310	Italy
14	People's Insurance Company	Insurance	75,377	1,952	China
15	Bank of China	Banking	73,230	27,970	China
16	Citigroup	Banking	72,850	16,672	United States
17	MetLife	Insurance	67,940	4,982	United States

Rank	Company	Industry	Revenue (USD millions)	Net Income (USD millions)	Headquarters
18	Bank of Communications	Banking	65,644	11,131	China
19	Dai-ichi Life	Insurance	64,794	2,029	Japan
20	Aegon	Insurance	64,223	2,618	Netherlands
21	Banco Bradesco	Banking	61,540	5,222	Brazil
22	Prudential Financial	Insurance	59,689	7,863	United States
23	Legal & General Group	Insurance	55,999	2,701	United Kingdom
24	China Merchants Bank	Banking	55,063	12,179	China
25	Munich Re	Insurance	54,090	2,530	Germany
26	China Pacific Insurance	Insurance	53,572	2,724	China
27	Banco Santander	Banking	53,340	8,600	Spain
28	Shanghai Pudong Development	Banking	50,545	8,453	China
29	Morgan Stanley	Investment Services	50,193	8,748	United States
30	MS&AD Insurance Group	Insurance	49,609	1,738	Japan
31	Tokio Marine Holdings	Insurance	49,395	2,476	Japan
32	American International Group	Insurance	47,390	-0.006	United States
33	Zurich Insurance Group	Insurance	47,180	3,716	Switzerland
34	BNP Paribas	Banking	46,840	8,820	France
35	CNP	Insurance	45,461	1,612	France

Rank	Company	Industry	Revenue (USD millions)	Net Income (USD millions)	Headquarters
	Assurances				
36	Sberbank	Banking	44,898	13,268	Russia
37	Royal Bank of Canada	Banking	44,609	9,635	Canada
38	Banco do Brasil	Banking	43,332	3,782	Brazil
39	China Minsheng Banking	Banking	43,298	7,370	China
40	American Express	Financial Services	43,281	6,921	United States
41	Itaú Unibanco Holding	Banking	42,700	6,500	Brazil
42	Talanx	Insurance	42,390	829	Germany
43	Goldman Sachs	Investment Services	42,254	4,286	United States
44	Mitsubishi UFJ Financial Group	Banking	41,280	9,820	Japan
45	TD Bank Group	Banking	41,198	8,751	Canada
46	Allstate	Insurance	39,815	2,252	United States
47	State Bank of India	Banking	39,090	120	India
48	Intesa Sanpaolo	Banking	39,050	4,780	Italy
49	Power Corporation of Canada	Insurance	37,118	1,033	Canada
50	Swiss Re	Insurance	37,047	462	Switzerland
51	Mizuho Financial Group	Banking	35,406	871	Japan
52	Sumitomo Mitsui Financial Group	Banking	35,170	8,207	Japan

Rank	Company	Industry	Revenue (USD millions)	Net Income (USD millions)	Headquarters
53	Credit Suisse Group	Investment Services	34,284	2,070	Switzerland
54	Crédit Agricole	Banking	33,747	5,351	France
55	Commonwealth Bank	Banking	33,186	7,228	Australia
56	Sompo Holdings	Insurance	32,857	1,322	Japan
57	Prudential	Insurance	32,553	4,035	United Kingdom
58	Standard Life	Insurance	32,114	868	United Kingdom
59	Bank of Nova Scotia	Banking	31,589	6,642	Canada
60	Travelers Cos	Insurance	30,282	2,523	United States
61	UBS	Investment Services	30,210	4,510	Switzerland
62	Manulife Financial	Insurance	30,070	3,703	Canada
63	Royal Bank of Scotland	Banking	28,984	2,218	United Kingdom
64	Barclays	Banking	27,865	3,126	United Kingdom
65	Deutsche Bank	Banking	27,492	378	Germany
66	Mapfre	Insurance	27,423	624	Spain
67	ANZ	Banking	27,147	4,863	Australia
68	Société Générale	Banking	26,380	3,780	France
69	BBVA	Banking	26,261	2,930	Spain
70	Onex	Investment Services	25,606	-0.663	Canada
71	Lloyds Banking Group	Banking	25,251	5,737	United Kingdom
72	Aviva	Insurance	91,840	3,481	United Kingdom

Rank	Company	Industry	Revenue (USD millions)	Net Income (USD millions)	Headquarters
73	FNMA (Fannie Mae)	Investment Services	21,900	16,000	United States
74	Aflac	Insurance	21,758	2,920	United States
75	UniCredit	Banking	21,070	5,212	Italy
76	Standard Chartered	Banking	20,976	1,109	United Kingdom
77	Old Mutual	Investment Services	20,923	938	United Kingdom
78	Freddie Mac	Investment Services	15,380	9,235	United States
79	Westpac Banking Group	Banking	14,710	5,412	Australia
80	National Australia Bank	Banking	12,770	3,713	Australia

17.8. SUMMARY

In many parts of the world, international financial institutions (IFIs) play a major role in the social and economic development programs of nations with developing or transitional economies. This role includes advising on development projects, funding them and assisting in their implementation. During recent years, IFIs have made considerable progress in harmonizing the way they procure goods and services. In many cases, they are now using similar policies and procedures, although the interpretation of these approaches may still vary at the level of the individual institution. In the sections that follow, we'll look at the common features of IFI procurement and how it works. International financial institutions provide businesses or governments with a loan for emergency purposes or for normal business functions. When these institutions provide money to another group, an element of risk is present. How the institutions manage these risks depends on the specific situations. High-risk circumstances typically include far more terms and conditions on the loan than a normal business loan. The following are the some of the aspects taken into consideration such as: Functions of International Financial Institutions, International Sources of Finance, Classification of main MDBs, List of Several "sub-regional" multilateral development banks, List of several multilateral financial institutions (MFIs), The Regional development bank, List of Bilateral Development Banks And Agencies.

17.9. TECHNICAL TERMS

Social Development: Social development means investing in people. It requires the removal of barriers so that all citizens can journey toward their dreams with confidence and dignity. It is about refusing to accept that people who live in poverty will always be poor. It is about helping people so they can move forward on their path to self-sufficiency.

Economic Development: Economic development is the process by which emerging economies become advanced economies. In other words, the process by which countries with low living standards become nations with high living standards. Economic development also refers to the process by which the overall health, well-being, and academic level the general population improves.

Multilateral Development Banks: Multilateral development banks are also referred to as an International financial institution (IFI). Multilateral development banks are established to help stabilize the global financial system. They now work as financing institutions that provide stable and long-term financing for various projects within developing countries.

Regional Development Bank: The Regional Development Bank, RDB is a financial institution established to provide investment capital for startup businesses and businesses provide financial assistance to businesses through the allocation of low-interest loans and grants for developing businesses.

17.10. SELF ASSESSMENT QUESTIONS

1. Define International Financial Institutions? What are the objectives of International Financial Institutions?
2. Discuss various Functions of International Financial Institutions
3. What are the International Sources of Finance,?
4. Classification of main MDBs,
5. What are the Several "sub-regional" multilateral development banks,
6. What are the several multilateral financial institutions (MFIs),
7. Discuss about the Regional development bank,
8. Discuss about Bilateral Development Banks And Agencies.

17.11. SUGGESTED READINGS

1. Adrain Buckley , Essential International Money, , Pearson Education
2. Adrian Buckley , International Finance, , Pearson Education
3. Alan Shapiro, Wiley, Foundations of Multinational Finance,
4. Multinational Financial Management, Alan Shapiro, Wiley
5. B.K.Chaudhri O.P. Agarwal , A Text book of Foreign Trade and Foreign Exchange, , Himalaya Pub. House

Dr. PL.V.V. Kumar

LESSON-18
WORLD BANK, IMF & OTHER IFIS

AIMS AND OBJECTIVES

After reading this lesson, you should be able to

- ❖ Explain the various dimensions of World Bank and IMF
- ❖ Know about various International financial institutions

STRUCTURE

18.1. INTRODUCTION

Origin of World Bank: Founded in 1944 at the UN Monetary and Financial Conference (commonly known as the Bretton Woods Conference), which was convened to establish a new, post-World War II international economic system, the World Bank officially began operations in June 1946. Its first loans were geared toward the postwar reconstruction of western Europe. Beginning in the mid-1950s, it played a major role in financing investments in infrastructural projects in developing countries, including roads, hydroelectric dams, water and sewage facilities, maritime ports, and airports.

The World Bank Group comprises five constituent institutions: the International Bank for Reconstruction and Development (IBRD), the International Development Association (IDA), the International Finance Corporation (IFC), the Multilateral Investment Guarantee Agency (MIGA), and the International Centre for Settlement of Investment Disputes (ICSID). The IBRD provides loans at market rates of interest to middle-income developing countries and creditworthy lower-income countries. The IDA, founded in 1960, provides interest-free long-term loans, technical assistance, and policy advice to low-income developing countries in areas such as health, education, and rural development. Whereas the IBRD raises most of its funds on the world's capital markets, the IDA's lending operations are financed through contributions from developed countries. The IFC, operating in partnership with private investors, provides loans and loan guarantees and equity financing to business undertakings in developing countries. Loan guarantees and insurance to foreign investors against loss caused by noncommercial risks in developing countries are provided by the MIGA. Finally, the ICSID, which operates independently of the IBRD, is responsible for the settlement by conciliation or arbitration of investment disputes between foreign investors and their host developing countries.

From 1968 to 1981 the president of the World Bank was former U.S. secretary of defense Robert S. McNamara. Under his leadership the bank formulated the concept of "sustainable development," which attempted to reconcile economic growth and environmental protection in developing countries. Another feature of the concept was its use of capital flows (in the form of development assistance and foreign investment) to developing countries as a means of narrowing the income gap between rich and poor countries. The bank has expanded its lending activities and, with its numerous research and policy divisions, has developed into a powerful and authoritative intergovernmental body.

The World Bank group is a multinational financial institution established at the end of World War II (1944) to help provide long-term capital for the reconstruction and development of member countries. The group is important to multinational corporations because it provides much of the planning and financing for economic development projects involving billions of dollars for which private businesses can act as contractors and suppliers of goods and engineering related services.

The World Bank is owned by more than 180 member countries whose views and interests are represented by a board of governors and a Washington based board of directors. Member countries are shareholders who carry ultimate decision making power in the World Bank. Each member nation appoints a governor and an alternate governor to carry out these responsibilities. The governors, who are usually officials such as ministers of finance or planning, meet at the Bank's annual meetings each fall. They decide on key Bank policy issues, admit or suspend country members, decide on changes in the authorised capital stock, determine the distribution of the IBRD's net income and endorse financial statements and budgets.

18.1.1. Objectives of the World Bank

The World Bank is the world's largest source of development assistance, providing nearly \$30 billion in loans, annually, to its client countries. The Bank uses its financial resources, its highly trained staff and its extensive knowledge base to individually help each developing country onto a path of stable, sustainable and equitable growth.

- To assist in the reconstruction and development of territories of members by facilitating the investment of capital for productive purposes, including the restoration of economies destroyed or disrupted by war, the reconversion of productive facilities to peacetime needs and encouragement of the development or productive facilities and resources in less developed countries.
- To promote private foreign investment by means of guarantees or participation in loans and other investments made by private investors; and when private capital is not available on reasonable terms, to supplement private investment by providing, on suitable conditions, finance for productive purposes out of its own capital, funds raised by it and its other resources.

- To promote the long-range balanced growth of international trade and the maintenance of equilibrium in balance of payments by encouraging international investment for the development of the productive resources of members, thereby assisting in raising productivity, the standard of living and condition of labour in their territories.
- To arrange the loans made or guaranteed by it in relation to international loans through other channels so that the more useful and urgent projects, large and small alike, can be dealt with first.
- To conduct its operations with due regard to the effect of international investment on business conditions in the territories of members and, in the immediate post-war years, to assist in bringing about a smooth transition from a wartime to a peacetime economy.
- The World Bank is the International Bank for Reconstruction and Development (IBRD) and the International Development Association (IDA). The IBRD has two affiliates, the International Finance Corporation (IFC) and the Multilateral Investment Guarantee Agency (MIGA). The Bank, the IFC and the MIGA are sometimes referred to as the "World Bank Group".

international organization affiliated with the United Nations (UN) and designed to finance projects that enhance the economic development of member states. Headquartered in Washington, D.C., the bank is the largest source of financial assistance to developing countries. It also provides technical assistance and policy advice and supervises—on behalf of international creditors—the implementation of free-market reforms. Together with the International Monetary Fund (IMF) and the World Trade Organization, it plays a central role in overseeing economic policy and reforming public institutions in developing countries and defining the global macroeconomic agenda.

18.1.2. Organization

The World Bank is related to the UN, though it is not accountable either to the General Assembly or to the Security Council. Each of the bank's more than 180 member states are represented on the board of governors, which meets once a year. The governors are usually their countries' finance ministers or central bank governors. Although the board of governors has some influence on IBRD policies, actual decision-making power is wielded largely by the bank's 25 executive directors. Five major countries—the United States, Japan, Germany, the United Kingdom, and France—appoint their own executive directors. The other countries are grouped into regions, each of which elects one executive director. Throughout the World Bank's history, the bank president, who serves as chairman of the Executive Board, has been an American citizen.

Voting power is based on a country's capital subscription, which is based in turn on its economic resources. The wealthier and more developed countries constitute the bank's major shareholders and thus exercise greater power and influence. For example, in the early 21st century the United States exercised nearly one-sixth of the votes in the IBRD, more than double that of Japan, the second largest contributor. Because developing countries hold only a small number of votes, the system does not provide a significant voice for these countries, which are the primary recipients of World Bank loans and policy advice.

The bank obtains its funds from the capital subscriptions of member countries, bond flotations on the world's capital markets, and net earnings accrued from interest payments on IBRD and IFC loans. Approximately one-tenth of the subscribed capital is paid directly to the bank, with the remainder subject to call if required to meet obligations.

The World Bank is staffed by more than 10,000 people, roughly one-fourth of whom are posted in developing countries. The bank has more than 100 offices in member countries, and in many countries staff members serve directly as policy advisers to the ministry of finance and other ministries. The bank has consultative as well as informal ties with the world's financial markets and institutions and maintains links with nongovernmental organizations in both developed and developing countries.

18.1.3. Debt and Policy Reform

The debt crisis of the early 1980s—during which many developing countries were unable to service their external debt to multilateral lending institutions, because of a slowdown in the world economy, high interest rates, a decline in commodity prices, and wide fluctuations in oil prices, among other factors—played a crucial role in the evolution of World Bank operations. The bank had become increasingly involved in shaping economic and social policies in indebted developing countries. As a condition of receiving loans, borrowing countries were required to implement stringent "structural adjustment programs," which typically included severe cuts in spending for health and education, the elimination of price controls, the liberalization of trade, the deregulation of the financial sector, and the privatization of state-run enterprises. Although intended to restore economic stability, these programs, which were applied in a large number of countries throughout the developing world, frequently resulted in increased levels of poverty, mounting unemployment, and a spiraling external debt. In the wake of the debt crisis, the World Bank focused its efforts on providing financial assistance in the form of balance-of-payments support and loans for infrastructural projects such as roads, port facilities, schools, and hospitals. Although emphasizing poverty alleviation and debt relief for the world's least developed countries, the bank has retained its commitment to economic stabilization policies that require the implementation of austerity measures by recipient countries.

The World Bank and the IMF played central roles in overseeing free-market reforms in eastern and central Europe after the fall of communism there in the 1980s and '90s. The reforms, which included the creation of bankruptcy and privatization programs, were controversial because they frequently led to the closure of state-run industrial enterprises. "Exit mechanisms" to allow for the liquidation of so-called "problem enterprises" were put into place, and labour laws were modified to enable enterprises to lay off unneeded workers. The larger state enterprises often were sold to foreign investors or divided into smaller, privately owned companies. In Hungary, for example, some 17,000 businesses were liquidated and 5,000 reorganized in 1992–93, leading to a substantial increase in unemployment. The World Bank also provided reconstruction loans to countries that suffered internal conflicts or other crises (e.g., the successor republics of former Yugoslavia in the late 1990s). This financial assistance did not succeed in rehabilitating productive infrastructure, however. In several countries the macroeconomic reforms resulted in increased inflation and a marked decline in the standard of living.

The World Bank is the world's largest multilateral creditor institution, and as such many of the world's poorest countries owe it large sums of money. Indeed, for dozens of the most heavily indebted poor countries, the largest part of their external debt—in some cases constituting more than 50 percent—is owed to the World Bank and the multilateral regional development banks. According to some analysts, the burden of these debts—which according to the bank's statutes cannot be canceled or rescheduled—has perpetuated economic stagnation throughout the developing world.

Demand and Engagement-Open Government Data Toolkit-Open Data in 60 Seconds-Open Data Essentials-Starting an Open Data Initiative-Technology Options-Demand and Engagement-Stage 1: Early Engagement-Stage 2: Capacity Development-Stage 3: Use & Re-use-Stage 4: Further Development-Open Data Communities-Additional Reading-Supply and Quality of Data-Readiness Assessment Tool-Technical Assistance and Funding

Central and local governments around the world are increasingly opening data and making them available for free, often as part of continuing efforts to further the reality of open government. While this has resulted in approval from development practitioners, government sponsors and technologists, the general public has not been widely engaged in the effort. As a result, the level of informed public debate on data-driven issues—from budgets, to service delivery, to the practical effectiveness of donor aid—is low, even in many of the "opened" sectors.

Increasing the level of awareness of Open Data and its potential value is of particular interest to government agencies, civil society organizations, technologists and journalists. As data are opened, however, capturing the attention and imagination of the full spectrum of data users and consumers remains a challenge. How do we engage the other side—the demand side—of the Open Data phenomenon? How can we grow communities of data users and encourage data "ownership" by the media, community groups, NGOs, labor unions, professional associations, universities and others? Realizing the full benefits of data use also means engaging civic hackers, also known as programmers and developers. Because data-driven products, apps, and content can improve quality of life, the global movement by developers to reclaim the term "hackers" and emphasize their positive contributions to civil society is gaining wider acceptance. When assessing engagement strategies and activities, the level of readiness of an Open Data initiative and the data literacy of its users are primary factors to consider. To engage a variety of stakeholders as an Open Data program develops, the following strategy addresses both the readiness level and the initiative's audience, and may help inspire and empower citizens to use Open Data and maximize value to the public in practical ways.

The strategy is comprised of four stages: Early Engagement, Capacity Development, Use & Re-use and Further Development.

18.1.4. Stage 1: Early Engagement: During the early stage, engagement strategies focus on identifying key data providers and consumers and encouraging them to take the first critical steps towards an Open Data initiative. On the provider side, engagement might mean identifying data managers in key government ministries and agencies; sometimes government staff need help understanding what data they already have. On the consumer side, engagement strategies might identify organizations that have both the incentive and the means to use Open Data immediately. For both audiences, early engagement often entails growing awareness of the use, benefits and opportunities presented by Open Data; identifying priorities and data demands for different audiences; building capacity; and supporting Open Data communities that already exist. The following events and programs are examples of effective Stage 1 strategies.

Open Data Sensitization Workshops. Designed for a variety of audiences, these events provide an overview of Open Data best practices and benefits, along with insights from countries, regions and partners about their experiences. One example is the Open Data Stakeholder Engagement Workshop, which was held during the January 2014 announcement of Nigeria's Open Data Initiative.

The Business Case for Open Data Roundtable. This high-level roundtable introduces the benefits of Open Data for social, economic and private sector growth and development, and attempts to catalyze leadership on both supply and demand sides. Information provided at this roundtable is customized for groups of decision-makers—including ministerial officials, local government leaders, CEOs, media owners, directors of civil society organizations and more—and twinned with support opportunities from the Bank and its close partners, such as the Data Literacy Bootcamp detailed in Stage 2. Examples include Media Leaders Roundtables on 'Open Data and the Future of News' held in Ghana, Kenya, Nepal, Tanzania and South Africa.

Data Liberation Scrape-a-thon. A two-day program that convenes international coders and sources local civic coders to collect existing, unstructured government data, re-structure them in machine-readable formats (e.g., CSV) and use them to populate a nascent or temporary Open Data platform. The program provides an opportunity to gain traction on the early Open Data process by capitalizing on what's already available and leveraging it to build momentum toward further opening by individual ministries. One such program supports the Hacks/Hackers Open News Scrape-a-thon in Chile, where "scraped" data is hosted for free on civically owned and communally managed repositories, such as OpenAfricaData.org and OpenDataLatinoAmerica.org.

18.1.4.2. Stage 2: Capacity Development: For any data to be useful, consumers must develop "data literacy": They must understand data, how to acquire data and how to apply data to specific needs. Stage 2 engagement strategies increase data literacy and technical capacity among potential users, including journalists, non-profit organizations, academics and software developers. The degree and style of technical training depends on the audience. Ideally, consumers would take part in multiple training opportunities as their needs require, and connect to local interest groups and communities of practice. The following courses and workshops address these objectives:

Open Data Literacy Bootcamps. These intensive three-day "learn-by-doing" workshops focus on core skills development for journalists, civil society and civic coders. Each participant is assigned a desktop computer in a classroom for hands-on, guided practicals. Sessions include demonstrations of Open Data catalogs; training on Excel/spreadsheets and creating pivot tables; scraping local county and national data; cleaning this data; creating visualizations; an introduction to GIS mapping; and ultimately crafting narratives around data, including an introduction to building apps and action plans. Example engagements include Data Literacy Bootcamps in India, Mexico, Singapore, South Sudan, Sudan, Bolivia, Ghana, Jordan, Nepal, Malawi, Moldova, South Africa, Tanzania, Tunisia, Ethiopia, Venezuela and Uruguay.

Open Data Master Classes. These classes provide intensive multi-week, bootcamp-style training for mid-career demand-side practitioners, which dives even deeper into data literacy experiential learning and skills building with data analysis.

E-Learning on Open Data Literacy. This weeks-long Open Data literacy e-learning course will launch in 2015 and demonstrate an even broader array of data literacy tools. It will be offered as both a facilitated and self-guided course to maximize utility for a broad audience. The courses will be free, open source and made available on multiple e-learning platforms.

18.1.4.3. Stage 3: Use & Re-use: The objective of Stage 3 is to harness Open Data in specific ways to address particular challenges and opportunities, and use Open Data to generate tangible value and results. Governments may already have policy priorities for which they are looking for solutions involving Open Data, and engagement at this stage can be designed to develop the beginnings of those solutions. In other cases, the private sector may have its own ideas and the goal may be to simply encourage innovation towards any public purpose imaginable. The following events and engagements target specific challenges and attempt to identify appropriate solutions:

Utility Hackathons. Utility hackathons are organized around particular development challenges where data has already been surfaced, such as through data liberation scrape-a-thons. Technologists typically use existing data to develop and build utility apps that solve development problems, with an emphasis on public service delivery. Winners may receive seed grants to build out and deploy utility apps and may be offered post-hackathon mentoring and advice to accelerate development/deployment and—more importantly—repurpose those utility apps in other country/regions to meet analogous needs. Examples of utility hackathons cut across key development areas, such as domestic violence, water quality and access and sanitation.

Apps Challenges and Competitions. Competitions are similar to hackathons, but typically emphasize competitive elements with prizes and/or recognition awarded by a judging panel. The rules of the competition specify the products or applications considered eligible to meet the sponsor’s goals. Examples include the Open Data Challenge, Apps for Development, Apps for Climate and the Food Security Open Data Challenge.

Prototype Funds. A partnership-driven process to connect well-developed utility app and data usage projects (i.e., those at the post-redesign/re-development stage, through prior mentorship and feedback) to angel investor-type funding to build out and deploy scalable models. An example of partnership-driven engagement is the Africa News Innovation Challenge.

18.1.4.4. Stage 4: Further Development: Once the Open Data initiative is firmly established, engagement strategies focus on ensuring that the initiative remains sustainable. This can mean reinforcing the efforts of earlier stages, propagating the initiative to other levels of government (from national to subnational or vice versa) and supporting data user communities both locally and nationally. The following are examples of programs and activities that advocate user sponsorship, fostering or participation to help sustain initiatives:

Code for [Your Country]. This is a partnership-driven, six-month Code Fellowship program, which collaboratively integrates top civic coders into government ministries to deploy coding skills to improve public service delivery, and into media and civil society organizations to strengthen the creation of data-driven content, products and services for mass public consumption, analysis and use. This initiative also improves transparent, accountable governance by supporting the identification and opening of demand-driven, actionable data and strengthening both data-driven analysis and decision-making at all levels. Examples of partnership-driven engagement include Code4Kenya, CodeforAfrica, Code for South Africa and Code for Nepal.

International and Regional Open Data Conferences. These conferences are sponsored by different organizations and held around the world. They offer learning opportunities for both data providers and consumers and connect affiliated communities of practice. Examples include sessions at the first and second International Open Government Data Conferences, Open Government Conference in Moscow and the first and second Regional Conferences on Open Data for Latin America and the Caribbean.

Open Data Communities. Organized user communities can provide sustained support and engagement over the long term. They can be locally based or part of international consortia. Examples include Hacks.Hacker chapters, GDGroups, ODI Nodes, OKFN Chapters and Data Cafes.

Open Data Communities: Organizations, user groups, blogs and other forums that advocate and support Open Data:

Open Knowledge Foundation (OKFN). Non-profit network that uses advocacy, technology and training to support the concept of open knowledge—i.e., universal access to key information and the ability for anyone to use information to their benefit—as mainstream

Sunlight Foundation. Nonpartisan non-profit that advocates for open government and uses Open Data technology tools, policy recommendations, journalism and grants to make government more accountable

Guardian Datablog. Data-related news from U.K.-based media company

Open Data Institute. U.K.-based organization that promotes Open Data through shared learning, research and training

Open Data Innovations Network. LinkedIn user group, supported by a World Bank-initiated knowledge partnership, that catalyzes and supports open government data initiatives and open innovation ecosystems in developing countries and helps facilitate adoption of Open Data tools, methods and principles

Civic Commons. Community-driven, civic-focused information resource that fosters the growth of a community of technologists who share information about their applications and application code to encourage governments to work together to solve common problems

European Public Sector Information Platform. Europe's "one-stop shop" for public sector information (PSI) re-use; an initiative of the European commission to promote a PSI and Open Data re-use market across the EU

Global Spatial Data Infrastructure (GSDI) Association. An association that promotes international cooperation and collaboration on spatial data to better address social, economic and environmental issues

Open Data for Development in Latin America and the Caribbean. A project to produce and expand knowledge on Open Data and its potential to improve public policies in this region;

offers an interactive open government data platform for dialogue between governments, citizens, developers and academics

Open Government Partnership. A multilateral initiative that secures concrete commitments from governments to promote transparency, empower citizens, fight corruption and harness new technologies to strengthen governance

Partnership for Open Data (POD). Global partnership to help policymakers and citizens in developing countries understand and exploit the benefits of Open Data

School of Data. Organization that works to empower civil society organizations, journalists and citizens with the skills they need to use data effectively

Social media channels. Follow #opendata, #opengov and#gov20 on Twitter

18.2. INTERNATIONAL MONETARY FUND (IMF)

Origin of IMF: The need for an organization like the IMF became evident during the great depression that ravaged the world economy in the 1930s. A widespread lack of confidence in paper money led to a spurt in the demand for gold and severe devaluation in the national currencies. The relation between money and the value of goods became confused as did the relation between the value of one national currency and another.

In the 1940s, Harry Dexter (US) and John Maynard Keynes (UK) put forward proposals for a system that would encourage the unrestricted conversion of one currency into another, establish a clear and unequivocal value for each currency and eliminate restrictions and practices such as competitive devaluations. The system required cooperation on a previously unattempted scale by all nations in establishing an. innovative monetary system and an international institution to monitor it. After much negotiations in the difficult war time conditions, the international community accepted the system and an organization was formed to supervise it. The IMF began operations in Washington DC in May 1946. It then had 39 members. The IMF’s membership now is 182.

The International Monetary Fund (IMF) is an organization of 188 countries, working to foster global monetary cooperation, secure financial stability, facilitate international trade, promote high employment and sustainable economic growth, and reduce poverty around the world. With its near-global membership of 188 countries, the IMF is uniquely placed to help member governments take advantage of the opportunities and manage the challenges—posed by globalization and economic development more generally. The IMF tracks global economic trends and performance, alerts its member countries when it sees problems on the horizon, provides a forum for policy dialogue, and passes on know-how to governments on how to tackle economic difficulties.

The IMF provides policy advice and financing to members in economic difficulties and also works with developing nations to help them achieve macroeconomic stability and reduce poverty. Marked by massive movements of capital and abrupt shifts in comparative advantage, globalization affects countries’ policy choices in many areas, including labor, trade, and tax policies. Helping a country, benefit from globalization while avoiding potential downsides is an important task for the IMF. The global economic crisis has highlighted just how interconnected countries have become in today’s world economy.

18.2.1. Key Activities of IMF

The IMF supports its membership by providing

- Policy advice to governments and central banks based on analysis of economic trends and cross-country experiences;
- Research, statistics, forecasts, and analysis based on tracking of global, regional, and individual economies and markets;
- Loans to help countries overcome economic difficulties;
- Concessional loans to help fight poverty in developing countries; and
- Technical assistance and training to help countries improve the management of their economies.

18.2.2. Objectives

The IMF was founded more than 60 years ago toward the end of World War II (see History). The founders aimed to build a framework for economic cooperation that would avoid a repetition of the disastrous economic policies that had contributed to the Great Depression of the 1930s and the global conflict that followed.

Since then the world has changed dramatically, bringing extensive prosperity and lifting millions out of poverty, especially in Asia. In many ways the IMF's main purpose to provide the global public good of financial stability is the same today as it was when the organization was established. More specifically, the IMF continues to

- To promote the flow of capital from developed to developing nations
- Provide a forum for cooperation on international monetary problems
- Facilitate faster and balanced growth of international trade, thus promoting job creation, economic growth, and poverty reduction;
- Promote exchange rate stability by curbing competitive exchange depreciations. And an open system of international payments; and
- Lend countries foreign exchange when needed, on a temporary basis and under adequate safeguards, to help them address balance of payments problems.
- To eliminate or reduce exchange controls imposed by member nations.
- To establish multilateral trade and payment system in respect of current transactions instead of bilateral trade agreements.
- .To solves the problem of international liquidity.

18.2.3. Functions of IMF

The functions of the IMF are grouped under three heads.

1. Financial – Assistance to correct short and medium term deficit in BOP;
2. Regulatory – Code of conduct and
3. Consultative - Counseling and technical consultancy

i) Bringing stability in exchange rate

The IMF is maintaining exchange rate stability and emphasizing devaluation criteria, restricting members to go in for multiple exchange rates and also to buy or sell gold at prices other than declared par value.

ii) Correcting BOP Disequilibrium

The IMF is helping the member countries in eliminating or minimizing the short-period disequilibrium in their balance of payments either by selling or lending foreign currencies to the member nation.

iii) Determining par values

IMF enforces the system of determination of par values of the currencies of the member countries. According to the Articles of Agreement of the IMF, every member nation should declare the par value of its currency in terms of gold or US dollars. Under this article, IMF ensures smooth working of the international monetary system, in favor of some developed countries.

iv) Balancing demand and supply of currencies

IMF is entrusted with the important function of maintaining balance between demand and supply of various currencies. The Fund (IMF) can declare a currency as scarce currency which is in great demand and can increase its supply by borrowing it from the country concerned or by purchasing the same currency in exchange of gold.

v) Reducing trade restrictions

The Fund also aims at reducing tariffs and other trade barriers imposed by the member countries with the purpose of removing restrictions on remittance of funds or to avoid discriminating practices.

vi) Providing credit facilities

IMF is providing different borrowing and credit facilities with the objective of helping the member countries. These credit facilities offered by it include basic credit facility, extended fund facility for a period of three years, compensatory financing facility and structural adjustment facility.

18.3. ASIAN DEVELOPMENT BANK (ADB)

The Asian Development Bank is a multilateral developmental finance institution founded in 1966 by 31 member governments to promote social and economic progress of Asian and the Pacific region. The Bank gives special attention to the needs of smaller or less developed countries and gives priority to regional/non - regional national programmes. In early 1960, the United National Economic Commission for Asia and Far East (UNECAFE) estimated that Asia and the Pacific region had an annual deficit of US $ one billion. The ADB was formed to fill this gap.

In194, the Asian Development Fund was established to streamline the bank's mean s of financing.During192- 6, the Banks' commitment to the DMCs increased from $316 million to 6 million. In the late 0s, the bank recognized the need to develop additional strategy to reduce poverty in the region, so they evolved the concept of multi-project loans which was a cost-effective means for funding projects too small for the Bank's involvement. In198, the Asian Development Fund was increased to 2.15 billion. 1986 was a significant year for the Bank because the Peoples Republic of China joined the Bank and India received her first loan of $ 100 million to the ICICI (Investment Credit and Investment Corporation of India) for one lending to Private Sector enterprises. In1993, annual lending commitments set $5 billion and the cumulative total by 1991 was $3.6 billion for 1039 projects.

18.4. THE REGIONAL DEVELOPMENT BANKS

The Inter-American Development Bank (IDB), the Asian Development Bank (ADB), and the European Bank for Reconstruction and Development (EBRD) are involved in post conflict reconstruction operations. The IDB, for example, has been the single largest source of external assistance in post conflict El Salvador and Guatemala, and chairs the donors' Consultative Groups for both countries. Similarly, the ADB has been an important source of post conflict assistance in Cambodia and Afghanistan, and the EBRD is engaged in the countries of the former Yugoslavia and the former Soviet republics. The role of the African Development Bank (AFDB) has been more limited, due to its recent restructuring and modest resources.

Notwithstanding these involvements, the regional development banks have yet to develop strategic policies and operational capacities specifically oriented to post conflict reconstruction and peace building. The IDB's operational policy on 'natural and unexpected disasters,' for example, contains no explicit reference to violent conflict; 'human-generated actions' are mentioned as a possible cause of disasters, but the policy focuses on natural disasters and, to a lesser extent, technological accidents such as oil spills and chemical releases. The IDB policy requires 'natural hazard risk assessment,' alongside environmental impact assessment, for all IDB-financed projects; conflict impact assessment is conspicuously missing.20 The IDB recently initiated a review of this policy, convening a seminar on 'Human Disasters: Conflict, Terrorism, and Technology' in June 2003.

Similarly, the ADB's Disaster Management handbook focuses exclusively on 'natural calamities ranging from earthquakes to volcanic eruptions and from cyclones to floods.'21 Spurred by its engagement in Afghanistan, the ADB announced in June 2003 that it is drafting a comprehensive emergency policy for conflict-affected countries. In sum, the regional development banks today are roughly where the World Bank was around eight years ago: they have begun to appreciate that the issues posed by conflict and post conflict peace building warrant explicit consideration, but they have yet to devise and institutionalize policies for addressing these issues, let alone build the new capacities that would be needed to implement these policies.

18.4.1. Objectives

(a) To facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income;

(b) To promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation;

(c) To assist in the establishment of multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions which hamper the growth of world trade?

(d) To shorten the duration and lessen the degree of disequilibrium in the balance of payments of members; and

(e) To promote international monetary co-operation through a permanent institution.

18.5. INTERNATIONAL BANK OF RECONSTRUCTION AND DEVELOPMENT (IBRD)

The International Bank of Reconstruction and Development (IBRD) is a development bank administered by the World Bank. The IBRD offers financial products and policy advice to countries aiming to reduce poverty and promote sustainable development. The International Bank of Reconstruction and Development is a cooperative owned by 189 member countries. The International Bank of Reconstruction and Development (IBRD) is one of two major institutions that make up the World Bank. The IBRD advises countries that are interested in limiting poverty and enabling sustainable development. Its main focus is on providing financing and economic policy advice to help the leaders of middle-income countries navigate the path toward greater prosperity.

Understanding the IBRD: The International Bank of Reconstruction and Development (IBRD) is one of the two major institutions that make up the World Bank, with the other being the International Development Association (IDA). The IDA is a financial institution dedicated to making developmental loans to the world's poorest countries. The IBRD was founded in 1944 with the goal of helping war-torn European countries rebuild their infrastructure and their economies. Following the recovery from World War II, the International Bank of Reconstruction and Development broadened its mandate to increasing global economic growth and eliminating poverty. Today, the IBRD focuses its services on middle-income countries or countries where the per capita income ranges from $1,026 to $12,375 per year. The IBRD adjusts these and other figures a bit yearly to account for inflation, economic changes within middle-income countries, and other factors.

These countries, like Indonesia, India, and Thailand, are often home to fast-growing economies that attract a lot of foreign investment and large infrastructure building projects. At the same time, middle-income countries are home to 70% of the world's poor people, as the benefits of this economic growth are unevenly distributed across their populations. The success of middle-income countries is precarious, as many economies that look promising will collapse under the weight of corruption and economic mismanagement.

The goal of the International Bank of Reconstruction and Development is to provide financing and economic policy advice to help the leaders of middle-income countries navigate the path toward greater prosperity. It will often help finance infrastructure projects that grow a country's economic potential while helping governments manage public finances and cultivate the confidence of foreign investors.

History of the IBRD: The IBRD was founded in anticipation of the end of World War II, during the Bretton Woods Conference of 1944, a gathering of the 44 Allied Nations of the Second World War meant to establish the post-war global financial order. Along with establishing a new global monetary policy regime, the Bretton Woods Conference was also where the International Monetary Fund and the IBRD were formed.

The first loan ever issued by the International Bank Of Reconstruction and Development was to the government of France, to help finance the reconstruction of critical infrastructure. Following the reconstruction of Europe, the IBRD shifted its focus to promoting economic development in other parts of the world.

18.6. MULTILATERAL INVESTMENT GUARANTEE AGENCY (MIGA)

An international agency constituted to promote large scale foreign investment projects in developing countries The Multilateral Investment Guarantee Agency, abbreviated as MIGA, is an international agency constituted to promote large scale foreign investment projects in developing countries. MIGA specializes in facilitating high-risk investments in low-income countries and supports projects that are socially, economically, and environmentally sustainable.

Multilateral Investment Guarantee Agency (MIGA): Headquartered in Washington DC, U.S., MIGA is a part of the World Bank Group, with 25 industrialized and 157 developing countries as its members as of May 2020. It is operated by a Council of Governors and headed by the Executive Vice President (Hiroshi Matano as of December 2019). With a capital stock of more than two billion dollars, the agency's adopted the following strategy moving forward: A focus on the world's poorest developing countries through support for projects. An emphasis on fragile and conflict-affected countries, where private players in the insurance industry are reluctant to go

A commitment to the 17 Sustainable Development Goals and climate change mitigation. The Multilateral Investment Guarantee Agency, abbreviated as MIGA, is an international agency established to promote large scale high-risk foreign investment projects in developing countries.

MIGA is a part of the World Bank Group with 25 industrialized and 157 developing countries as its members as of May 2020. It primarily offers political risk insurance, which secures an investment against threats of political instability, civil wars, terrorism, etc.

Services Offered by the Multilateral Investment Guarantee Agency: The Multilateral Investment Guarantee Agency primarily offers political risk insurance, which secures an investment against threats of political instability, civil wars, terrorism, etc. It provides guarantees against non-commercial risks to foreign direct investment projects in various sectors, including agribusiness, banking, financial markets, infrastructure, power and renewable energy, solid waste management, telecommunication, tourism, and transportation. it boosts the confidence of both investors and lenders concerning the safety and return of their investment. MIGA charges investors an insurance premium like any other insurance agency. The agency also advises governments on the best ways to attract and retain private investment, thus enabling rapid and sustained growth of their economies. Its services include licensing, franchising, and technology support. Additionally, it strives to add value to its clients by offering them extensive knowledge of emerging markets across the globe.

The Four Pillars of MIGA: 1. Growing Core Business, 2. Innovative Applications, 3. Maximizing Project Impact, 4. Creating Markets

History of MIGA: The need for a multilateral political risk insurance provider was first felt in 1948. In September 1985, the idea started to materialize when the World Bank's Board of Governors endorsed the MIGA Convention with the core mission of enhancing the flow of capital and technology to developing countries. MIGA was established as a member of the World Bank Group in April 1988. It commenced its operations with a capital stock of $1 billion and 29 original member countries. The agency derived strength from its multilateral character and joint sponsorship by developed and developing countries. By 2010, MIGA's successfully issued 922 guarantees worth $18.8 billion. **Examples of MIGA Projects**

Malawi, Africa: In 2019, MIGA issued guarantees to support the development, construction, and operation of a new solar photovoltaic plant in Salima, a province in the central region of Malawi, Africa. Malawi's electrification rate relative to global standards was dismally low, with its installed generation capacity majorly dependent on hydropower and vulnerable to the impacts of climate change. The project insured one of the first Independent Power Producers (IPP) in Malawi for adding a new source of energy supply in a country.

Belgrade, Serbia: In 2018, MIGA provided insurance to foreign investors for the construction and operation of a new waste management facility with electricity and heat generation components in Belgrade, Serbia. The project aimed to reduce the burden on Belgrade for the processing of municipal waste, thereby freeing up landfill capacity in the city.

Quito, Ecuador: In 2010, MIGA supported investors in the construction of a new airport to serve the capital of Ecuador – Quito – to improve and expand economic development and trade. The Mariscal Sucre International Airport ultimately opened in February 2013 and soon became one of the busiest airports in South America.

18.7.INTERNATIONAL CENTRE FOR SETTLEMENT OF INVESTMENT DISPUTES

The International Centre for Settlement of Investment Disputes (ICSID) is an international arbitration institution established in 1966 for legal dispute resolution and conciliation between international investors and States. ICSID is part of and funded by the World Bank Group, headquartered in Washington, D.C., in the United States. It is an autonomous, multilateral specialized institution to encourage international flow of investment and mitigate non-commercial risks by a treaty drafted by the International Bank for Reconstruction and Development's executive directors and signed by member countries.[3][4] As of May 2016, 153 contracting member states agreed to enforce and uphold arbitral awards in accordance with the ICSID Convention.

History: In the 1950s and 1960s, the Organisation for European Economic Cooperation (now the Organisation for Economic Co-operation and Development) had made several attempts to create a framework to protect international investments, but its efforts revealed conflicting views on how to provide compensation for the expropriation of foreign direct investment.

Creation: In 1961, Aron Broches, then-General Counsel of the International Bank for Reconstruction and Development (IBRD), developed the idea for a multilateral agreement on a process for resolving individual investment disputes on a case-by-case basis as opposed to imposing outcomes based on standards. Broches held conferences to consult legal experts from all parts of the world, including Europe, Africa, and Asia, to discuss and compose a preliminary agreement. The IBRD staff wrote an official draft of the agreement and consulted with legal representatives of the IBRD's board of directors to finalize the draft and have it approved.

The board of directors approved the final draft of the agreement, titled Convention on the Settlement of Investment Disputes between States and Nationals of Other States, and the Bank president disseminated the convention to its member states for signature on 18 March 1965. Twenty states immediately ratified the convention. The convention established the ICSID would become officially active on 14 October 1966.[3][5][page needed][6][page needed]

Disputes settled: The Indonesian government was sued in June 2012 by a London-based mining company Churchill Mining after the local government revoked the concession rights held by a local company in which the firm had invested.[7] The government is countering the Churchill case, claiming that Churchill did not have the correct type of mining licences.[7]

In October 2012, an ICSID tribunal awarded a judgement of $1.8 billion for Occidental Petroleum against the government of Ecuador.[7] Additionally, Ecuador had to pay $589 million in backdated compound interest and half of the costs of the tribunal, making its total penalty around $2.4 billion.[7] The South American country annulled a contract with the oil firm on the grounds that it violated a clause that the company would not sell its rights to another firm without permission. The tribunal agreed the violation took place but judged that the annulment was not fair and equitable treatment to the company.[7]

Irish oil firm Tullow Oil took the Ugandan government to court in November 2012 after value-added tax (VAT) was placed on goods and services the firm purchased for its operations in the country.[8] The Ugandan government responded that the company had no right to claim tax on such goods prior to commencement of drilling.

Tobacco major Philip Morris sued Uruguay for alleged breaches to the Uruguay-Swiss BIT for requiring cigarette packs to display graphic health warnings and sued Australia under the Australia-Hong Kong BITS for requiring plain packaging for its cigarettes. The company claimed that the packaging requirements in both countries violate its investment.[7]

In the context of Nuclear power phase-out in Germany, Swedish Energy company Vattenfall sought compensation from the German government for the premature shut-down of nuclear plants.[9][10]

Performance since creation: Bilateral investment treaties (BITs) proliferated during the first decade of the 21st century, reaching more than 2,500 by 2007. Many such treaties contain text that refers present and future investment disputes to ICSID.[11]

As of 30 June 2012, ICSID has registered 390 disputes.[12]:7 ICSID's caseload consisted of 88% convention arbitration cases, 2% convention conciliation cases, as well as 9% additional facility arbitration cases, and 1% additional facility conciliation cases.[12]:8 ICSID's registered cases were distributed across oil, gas and mining (25%), electricity and other energy (13%), other industries (12%), transportation industry (11%), construction industry (7%), financial industry (7%), information industry and communication industry (6%), water industry, sanitation, and food protection (6%), agriculture, fishing, and forestry (5%), services and trade (4%), and tourism industry (4%).[12]:12

As of 27 July 2012, 246 of 390 registered arbitration cases were concluded, as of 30 June 2012, ICSID tribunals had resolved nearly two thirds (62%) of disputes while the remainder (38%) were settled or discontinued.[12]:13 As of 14 May 2016, 362 of 574 (62%) registered arbitration cases were concluded.[13]

Conciliation commission reports were issued for 67% of the conciliation proceedings, while 33% of proceedings were discontinued. In 75% of the conciliation reports, parties failed to reach an agreement, and only 25% recorded agreement among parties.[14]

As of 2012 only two governments, Gabon and Romania, had ever filed an ICSID case against an investor. States appearing most often as a respondent were in descending order: Argentina 49, Venezuela 36, Egypt 17, Ecuador 12, Congo 12, Peru 11 and Ukraine 10 times. Between 2009 and 2012, legal representation cost between US$1 and 7.6 million. The approximate duration of a case was 3.6 years.[15]

As of 2019, ICSID's caseload included 2% conciliation cases.[16] The rest were arbitrations.

Governance: ICSID is governed by its Administrative Council which meets annually and elects the centre's secretary-general and deputy secretary-general, approves rules and regulations, conducts the centre's case proceedings, and approves the centre's budget and annual report. The council consists of one representative from each of the centre's contracting member states and is chaired by the President of the World Bank Group, although the president may not vote. ICSID's normal operations are carried out by its secretariat, which comprises 40 employees and is led by the secretary-general of ICSID. The secretariat provides support to the Administrative Council in conducting the centre's proceedings. It also manages the centre's Panel of Conciliators and Panel of Arbitrators. Each contracting member state may appoint four persons to each panel.[6]:15 In addition to serving as the centre's principal, the secretary-general is responsible for legally representing ICSID and serving as the registrar of its proceedings. As of 2012, Meg Kinnear serves as the centre's secretary-general.[4]

Membership:

ICSID in force
ICSID signed, ratification pending
Former members, withdrawn
ICSID's 163 member states which have signed the centre's convention include 162 United Nations member states plus Kosovo. Of these member states, 154 are "contracting member states", that is they have ratified the contract.[1] Former members are Bolivia and Venezuela, which withdrew in 2012.[17] Ecuador withdrew from the ICSID Convention in 2009 but rejoined in 2021.[18] All ICSID contracting member states, whether or not they are parties to a given dispute, are required by the ICSID Convention to recognize and enforce ICSID arbitral awards.[6]

Non-contracting signatories: The following member states have signed the ICSID convention (date in parentheses), but have not ratified it.[1]

Belize (1986)	Djibouti (2019)	Dominican Republic (2000)	Ethiopia (1965)
Guinea-Bissau (1991)	Kyrgyzstan (1995)	Namibia (1998)	Russia (1992)
Thailand (1985)			

Non members: Brazil, India and South Africa are countries with large economies that have never been ICSID members.

Activities: ICSID does not conduct arbitration or conciliation proceedings itself, but offers institutional and procedural support to conciliation commissions, tribunals, and other committees which conduct such matters. The centre has two sets of rules that determine how cases will be initiated and conducted, either under the ICSID Convention, Regulations and Rules or the ICSID Additional Facility Rules. To be processed in accordance with the ICSID Convention, a legal dispute has to exist between one of the centre's contracting member states and a national of another contracting member state. It must also be of a legal nature and relate directly to an investment. A case can be processed under the ICSID Additional Facility Rules if one of the parties to the dispute is either not a contracting member state or a national of a contracting member state. However, most cases are arbitrated under the ICSID Convention.[19][20][21] Recourse to ICSID conciliation and arbitration is entirely voluntary. However, once the parties have consented to arbitration under the ICSID Convention, neither party can unilaterally withdraw its consent.[22]

The ICSID Secretariat may also administer dispute resolution proceedings under other treaties and regularly assists tribunals or disputing parties in arbitrations among investors and states under the United Nations Commission on International Trade Law (UNCITRAL)'s arbitration regulations. The centre provides administrative and technical support for a number of international dispute resolution proceedings through alternative facilities such as the Permanent Court of Arbitration in The Hague, Netherlands, the London Court of International Arbitration, and the International Chamber of Commerce in Paris, France.[19]

ICSID also conducts advisory activities and research and publishes Investment Laws of the World and of Investment Treaties.[23] Since April 1986, the centre has published a semi-annual law journal entitled ICSID Review: Foreign Investment Law Journal.[24]

Although ICSID's proceedings generally take place in Washington, D.C., parties may agree that proceedings be held at one of a number of possible alternative locations, including the Permanent Court of Arbitration, the Regional Arbitration Centres of the Asian-African Legal Consultative Committee in Cairo, in Kuala Lumpur, or in Lagos, the Australian Centre for International Commercial Arbitration in Melbourne, the Australian Commercial Disputes Centre in Sydney, the Singapore International Arbitration Centre, the Gulf Cooperation Council Commercial Arbitration Centre in Bahrain, the German Institution of Arbitration, the Maxwell Chambers in Singapore, the Hong Kong International Arbitration Centre, and the Centre for Arbitration and Conciliation at the Chamber of Commerce of Bogota.[25]

Criticism: See also: Bilateral investment treaty § Criticism
ICSID has sometimes been the target of criticism about grossly inequitable judgements. Notably, Jeffrey Sachs suggested that the US$5.9 billion judgement against Pakistan in relation to rights presumed by Tethyan Copper Company amounted to a "flawed and corrupt investment arbitration process".[26] The Pakistan Supreme Court had voided a transaction entered into by Balochistan Development Authority finding in favour of Antofagasta PLC of Chile and Barrick Gold Corporation of Canada. Nevertheless, others[27] have suggested this amount is a fair reflection of the fact that a potentially extraordinary asset (Reko Diq Mine) had effectively been seized seemingly without good reason.

18.8. SUMMARY

The international financial organizations are performing a major role globally. The most familiar is the World Bank, formally known as the International Bank for Reconstruction and Development (IBRD). The World Bank has two affiliates that are legally and financially distinct entities, the International Development Association (IDA). IMF lending aims to give countries breathing room to implement adjustment policies and reforms that will restore conditions for strong and sustainable growth, employment, and social investment. These policies will vary depending upon the country’s circumstances, including the causes of the problems. Globalization has vastly increased the size of private capital flows relative to official flows and IMF quotas, albeit unevenly so.

18.9. TECHNICAL TERMS

International Banking: International banking is like any other banking service, but it takes place across different nations or internationally. To put it another way, it is an arrangement of financial services by a residential bank of one country to the residents of another country. Most multinational companies and individuals use this banking facility for transacting. International banking forms a major part of the international financial market.

I.D. Association: The International Development Association (IDA) (French: Association internationale de développement) is an international financial institution which offers concessional loans and grants to the world's poorest developing countries. The IDA is a member of the World Bank Group and is headquartered in Washington, D.C. in the United States.

World Bank: The World Bank is an international financial institution that provides loans and grants to the governments of low- and middle-income countries for the purpose of pursuing capital projects. The World Bank is the collective name for the International Bank for Reconstruction and Development (IBRD) and International Development Association (IDA), two of five international organizations owned …

IMF: The International Monetary Fund (IMF) is an international organization that promotes global economic growth and financial stability, encourages international trade, and reduces poverty.

18.10. SELF ASSESSMENT QUESTIONS

1. Explain about various International Financial Institutions?
2. Explain the functions of World Bank?
3. What do you know about International Monitory fund, explain its Functions?
4. Discuss about Asian Development Bank.
5. Explain briefly regarding Regional Development Bank

18.11. SUGGESTED READINGS

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Dr. P.V.V.Kumar

LESSON-19
IFC, IDA, IBRD & IFAS

AIMS AND OBJECTIVES

- Awareness about the International Financial Institutions (IFI)
- Know about the IFC & International Development Agency(IDA)
- Understand about IBRD and IFAs like IDA, MIGA

STRUCTURE

19.1. INTRODUCTION

The International financial institutions are an important source of external finance. With the changing world economy since 1945 partly due to Bretton Woods system or partly due to various trade unions first under GATT and then under WTO, the role and functions of these financial institutions have also changed. In the present Unit, you will learn about some of this aspect, related to international institutions like IFC, IDA, Multilateral, national and international public financial institutions should play a major role in providing investments to meet the climate and other sustainability challenges, as well as to meet the goals of the Paris Agreement. These institutions have begun an important shift towards sustainability—but more is needed to ensure that all public development finance supports, rather than undermines, our shared climate goals. The institutions include the International Monetary Fund and the multilateral development banks (MDBs); specialized funds such as the Green Climate Fund (GCF), the Adaptation Fund, and the Climate Investment Funds; and bilateral and national development finance institutions.

By analyzing their investment portfolios and policies and identifying opportunities for change, we help enable financial institutions to shift their investments toward sustainable and climate-compatible development. Our engagement consists of timely analysis, convening of key stakeholders, and direct engagement with the institutions. We focus this work on:

- Enhancing the quality and quantity of the development banks' dedicated climate finance;
- Ensuring alignment of the banks' overall investment portfolios with global climate adaptation and mitigation goals; and

- Promoting bank policies and practices that protect vulnerable people and ecosystems.

International financial institutions play a central role in helping to fund activities in developing countries that support sustainable, climate resilient, and low-carbon development. By analyzing their investment portfolios and identifying opportunities for change, we help enable these institutions to shift their investments toward sustainable and climate compatible development.

We rely on our deep knowledge of these institutions, the UNFCCC finance negotiations, and of the climate finance architecture; on our convening power; and on our in-house sectoral expertise to produce timely research products to inform key decisions. While our efforts apply to a broad range of financial institutions, our focus is primarily on:

- MDB policies, practices, and governance
- Policies, practices, and governance of specialized climate funds, especially the GCF
- UNFCCC finance negotiations
- IDFC analytical and strategic activities

In addition to the MDBs, other development finance institutions (DFIs), such as national, bilateral, and regional development banks, play an important and growing role in financing sustainable development, including providing climate finance. We have also begun research to better understand the role of the International Monetary Fund in sustainability.

19.2. IFC – INTERNATIONAL FINANCE CORPORATION

This organization is another private arm of the World Bank and was established in the year 1956. The different thing under this institution is that it lends money to the private sector in the developing economy to the member nations. The interest rates provided to the companies are commercial but at a very low rate. Furthermore, it also provides the advice and finances the public-private partnership along with the private investors. So, there is a specific condition under which it lends the money to private institutions. Also, the institution invests the money only when a special contribution is made that matches the complements the role played by the market investors in terms of a foreign financial investor.

IFC is a member of the World Bank Group, which consists of five closely associated institutions that are owned by member countries. Each plays a distinct role in helping fight poverty and improve lives.IFC promotes economic development through private sector. Working with business partners, IFC invests in sustainable private enterprises in developing countries without the need for government guarantees. This direct lending to businesses is the fundamental contrast between IFC and the World Bank: under their Articles of Agreement, IBRD and IDA can only lend to the governments of member countries. IFC was founded specifically to address this limitation in World Bank lending.IFC also offers advisory services to support private sector development. Most of these activities are funded in partnership with donor countries; many involve close collaboration with the World Bank.

19.2.1. Objectives and Working of International Finance Corporation (I.F.C.)

The International Finance Corporation was established in July 1956, with the specific subject of providing finance to the private sector. Though it is affiliated to the World Bank, it is a separate legal entity with separate fund and functions. Members of the World Bank are eligible for its membership.

Objectives:

- IFC's objective is to assist economic development by encouraging the growth of productive private enterprise in its member nations, particularly in the underdeveloped areas.
- To invest in productive private enterprises, in association with private investors, and without government guarantee of repayment, in cases where sufficient private capital is not available on reasonable terms.
- To serve as a clearing house to bring together investment opportunities, private capital (both foreign and domestic) and experienced management.
- To help in stimulating the productive investment of private capital, both domestic and foreign.

19.2.2. Functions of IFC

- IFC provides a wide range of investment and advisory services that help businesses and entrepreneurs in the developing world meet the challenges they face in the marketplace.IFC offers innovative financial products to private sector projects in developing countries. These include loans for IFC's own account (also called A-loans), equity financing, quasi-equity financing, syndicated loans (or B-loans), risk management products, and partial credit guarantees. IFC often provides funding to financial intermediaries that on-lend to clients, especially small and medium enterprises.
- IFC also provides advisory services that help build businesses. Much of IFC's advisory work is conducted by facilities managed by IFC but funded through partnerships with donor governments and other multilateral institutions. Other sources of funding include donor country trust funds and IFC's own resources.IFC can provide a mix of financing and advisory services that is tailored to meet the needs of each project. But the bulk of the funding, as well as leadership and management responsibility, lies with private sector owners and investors.

IFC investments are for the establishment ne1x enterprises as well as for the expansion and modernization of existing ones. They cover a wide range of projects such as steel, textile production, mining, manufacturing, machinery production, food processing, tourism and local development finance companies. Some projects are locally owned, whereas others are joint ventures between investors in developing and developed countries. In a few cases, joint ventures are formed between investors of two or more developing countries. The IFC has also been instrumental in helping to develop emerging capital markets.

19.3. INTERNATIONAL DEVELOPMENT ASSOCIATION (I.D.A.)

The International Development Association (IDA) is the part of the World Bank that helps the world's poorest countries. It was established in 1960 to complement the existing International Bank for Reconstruction and Development by lending to developing countries which suffer from the lowest gross national income, from troubled creditworthiness, or from the lowest per capita income. The International Development Association (IDA) is the part of the World Bank that helps the world's poorest countries. It was established in 1960 to complement the existing International Bank for Reconstruction and Development by lending to developing countries which suffer from the lowest gross national income, from troubled creditworthiness, or from the lowest per capita income.

19.3.1. Origin of International Development Association

The International Development Association began after World War II. The consequences of the war on finances put the developing and underdeveloped countries under extreme pressure. Initially, this organization assisted the International Bank for Reconstruction and Development, which already existed (IBRD). The founding of the International Development Association did more than add to the capabilities of the IBRD. It helped the LDCs (Least Developed Countries) enhance their low national income. The first country to gain benefits from the International Development Association was the government of France to improve its economic status.

The IDA was formed in 1960 as a part of the World Bank Group to provide financial support to LDCs on a more liberal basis than could be offered by the IBRD. The IDA has 13 member countries, although all members of the IBRD are free to join the IDA. IDA's funds come from subscriptions from its developed members and from the earnings of the IBRD. Credit terms usually are extended to 40 to 50 years with no interest. Repayment begins after a ten-year grace period and can be paid in the local currency, as long as it is convertible. Loans are made only to the poorest countries in the world, those with an annual per capita gross national product of $480 or less. More than 40 countries are eligible for IDA financing.

An example of an IDA project is a $8.3 million loan to Tanzania approved in 1989 to implement the first stage in the longer-term process of rehabilitating the country's agricultural research system. Co financing is expected from several countries as well as other multilateral lending institutions. Although the IDA's resources are separate from the IBRD, it has no separate staff. Loans are made for similar projects as those carried out by IBRD, but at easier and more favorable credit terms.

As mentioned earlier, World Bank/IDA assistance historically has been for developing infrastructure. The present emphasis seems to be on helping the masses of poor people in the developing countries become more productive and takes an active part in the development process. Greater emphasis is being placed on improving urban living conditions and increasing productivity of small industries.

19.3.2. Objectives-International Development Association

The objectives of the International Development Association are as follows Reduce Poverty: Provides loans at zero or no interest, preventing least developed countries from borrowing from commercial banks at higher interest rates.

i. Building a Sturdy Economic Structure
ii. The IDA provides countries with sustainable development finance to nations with credit risks.
iii. Boosting Economic Growth: The IDA aims to provide the countries with long-term financial support for economic restoration and stability.
iv. Improve the quality of living: IDA helps enhance a country's economic status, reduce inequality and alleviate poverty. Therefore, they can improve their standards of living significantly.
v. To provide development finance on easy terms to less developed member countries. To promote economic development, increase productivity and thus, raise the standards of living in the underdeveloped areas.

19.3.3. Functions-International Development Association:

i. International Development: International development has the goal of improving the well-being of the world's poorest and most vulnerable people without compromising the ability of future generations to meet their needs. The Millennium Development Goals and aid effectiveness principles are important reference points guiding Inter Action's efforts to advance key priorities in international development. Inter Action works with and through its member organizations to strengthen policies and programs to reduce poverty, hunger, gender and social inequity and environmental degradation in more than 100 countries.
ii. Accountability & Learning: NGOs are accountable to multiple constituencies, including donors, the public, their boards of directors and staff, partners and the people they serve or represent.
iii. Humanitarian Action: The primary objective of humanitarian action is to save lives, alleviate suffering and maintain human dignity, without regard for race, ethnicity, religion or political affiliation.
iv. Policy & Advocacy: Inter Action is the nation's leading advocate for international relief and development programs and the prime representative of U.S.-based international NGOs.

19.3.4. IDA & Its Finance Operation

i. IDA-financed operations address primary education, basic health services, clean water and sanitation, environmental safeguards, business climate improvements, infrastructure and institutional reforms. These projects pave the way toward economic growth, job creation, higher incomes and better living conditions. It emphasizes broad-based growth, including:
ii. Sound economic policies, rural development, private business, and sustainable environmental practices
iii. Investment in people, in education and health, especially in the struggle against HIV/AIDS, malaria, and TB
iv. Expansion of borrower capacity to provide basic services and ensure accountability for public resources
v. Recovery from civil strife, armed conflict, and natural disaster.
vi. Promotion of trade and regional integration

19.3.5. Impact of International Development Association

i. The International Development Association provides quality of life, increasing the standards of living.
ii. The main emphasis of this association is to bring necessities like clean drinking water, electricity, and shelter to people of developing countries.
iii. In countries like Africa, this association has approximately helped around 66 million Africans since 198, providing them with electricity and enrolling 15 million children in schools for better education.
iv. Countries like Indonesia and India are hubs for a lot of foreign Investment.
v. On the other hand, 0% of the global poor benefited from the IDA.
vi. However, in some middle-income countries, the distribution was either uneven or was plagued with corruption and economic mismanagement.

19.3.5. International Development Association Funding

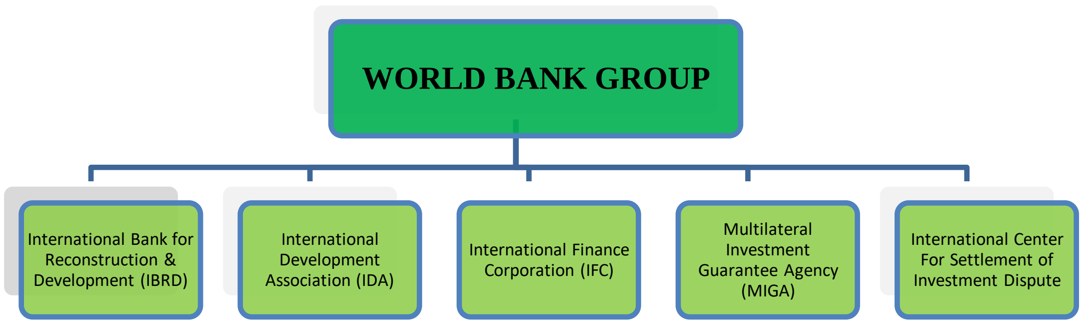
i. The International Development Association exclusively requires the planning of its resources regularly. Its member countries meet every three years to understand the requirements and make donations.

ii. Most recently, in December 2019, it was refilled with $82 billion, and again in 2020 due to increased usage of resources during the COVID - 19 times.

iii. The International Development Association introduced 20 exclusive themes to cover all aspects of existence. It includes pressing issues such as Climate Change, Human Capital, Gender and Development, Human Capital, etc. Currently, IDA is working on 1828 projects across 9,91 locations in 9 countries, spending around $161.48 billion.

19.4. INTERNATIONAL BANK OF RECONSTRUCTION AND DEVELOPMENT (IBRD)

The International Bank for Reconstruction and Development (IBRD), otherwise called the World Bank (WB) was established in 1945 under the Bretton Woods Conference in 1944 after the end of the Second World War. The purpose is to bring about a smooth transition from war-time to peace-time economy. It is known as a sister institution along with the International Monetary Fund. World Bank Group is composed of five organizations, and IBRD is one of them. The head quarter of IBRD is located in Washington D.C, United States. The primary motive of IBRD at the initial stages was to provide financial aid for the reconstruction and development of the European counties that were devastated by World War II. As the staff and leadership of the International Development Association (IDA) and the IBRD are the same they are collectively referred to as World Bank. The membership in International Monetary Fund is a prerequisite to become a member of IBRD. The IBRD was established to provide long term financial assistance to member countries.



Apart from the reconstruction and development of counties destroyed by wars this bank also lends loans to financially weaker countries to eradicate poverty and promote economic development. The IBRD also provides commercial loans to some sovereign states to improve some important sectors like infrastructure, health care, sanitation, education, etc. At present 189 counties are members of the IBRD and these countries act as a governing body and the owner of the IBRD. The member countries of IBRD are its shareholders and thus reserve the right to vote in its internal matters.

19.4.1. International Bank For Development & Reconstruction (IBRD)

The bank established in 1945 and is one of the oldest banking institutions in the world. Also, it helps the underdeveloped economies by lending them the money at a very low-interest rate. There are many areas in which this institution works. Some of the main areas include irrigation, agriculture, healthcare, family welfare, urban development, and dairy development.

19.4.2. International Bank for Reconstruction and Development

The IBRD was set up in 1945 along with the IMF to aid in rebuilding the world economy. It was owned by the governments of 151 countries and its capital is subscribed by those governments; it provides funds to borrowers by borrowing funds in the world capital markets, from the proceeds of loan repayments as well as retained earnings. At its funding, the bank's major objective was to serve as an international financing facility to function in reconstruction and development. With Marshall Plan providing the impetus for European reconstruction, the Bank was able to turn its efforts towards the developing countries.

Generally, the IBRD lends money to a government for the purpose of developing that country's economic infrastructure such as roads and power generating facilities. Funds are directed towards developing countries at more advanced stages of economic and social growth. Also, funds are lent only to members of the IMF, usually when private capital is unavailable at reasonable terms. Loans generally have a grace period of five years and are repayable over a period of fifteen or fewer years.

The projects receiving IBRD assistance usually require importing heavy industrial equipment and this provides an export market or many US goods. Generally bank loans are made to cover only import needs in foreign convertible currencies and must be repaid in those currencies at long-term rates. The government assisted in formulating and implementing an effective and comprehensive strategy for the development of new industrial free zones and the expansion of existing ones; reducing unemployment, increasing foreign-exchange earnings and strengthening backward linkages with the domestic economy; alleviating scarcity in term financing; and improving the capacity of institutions involved in financing, regulating and promoting free zones.

The World Bank lays special operational emphasis on environmental and women's issues. Given that the Bank's primary mission is to support the quality of life of people in developing member countries, it is easy to see why environmental and women's issues are receiving increasing attention. On the environmental side, it is the Bank's concern that its development funds are used by the recipient countries in an environmentally responsible way. Internal concerns, as well as pressure by external groups, are responsible for significant research and projects relating to the environment.

The women's issues category, specifically known as Women In Development (WID) is part of a larger emphasis on human resources. The importance of improving human capital and improving the welfare of families is perceived as a key aspect of development. The WID initiative was established in 1988 and it is oriented to increasing women's productivity and income. Bank lending for women's issues is most pronounced in education, population, health and nutrition and agriculture.

19.4.3. The Objective of IBRD: IBRD's main objective is to provide financial assistance to middle-income countries, however, it also provides information services and strategic coordination to its borrowing member countries. IBRD only finances government-backed projects or directly finances sovereign governments. The loans offered by this bank have a long-term maturity period say 30 years, with a nominal or zero interest rate. Also, IBRD offers the loan in the local currency of a particular nation to avoid conversion charges. With the collaboration of the International Finance Corporation and IBRD, the bank offers loans with or without sovereign guarantees.

19.4.4. Functions of IBRD:

A. Financial Resources: Authorized capital: At its establishment, the IBRD had an authorized capital of US$ 10 billion. Countries subscribing shares were required to pay in only one-fifth of their subscription on joining, the remainder being available on call but only to meet the IBRD's liabilities if it got into difficulties. Moreover, not even the one-fifth had to be paid in hard cash at that time. The sole cash requirement was the payment in gold or US dollars of 2% of each country's subscription. A further 18% of the subscription was payable in the currency of the member country concerned, and although this sum was technically paid in, in the form of notes bearing no interest, it could not be used without the member's permission. In 1959, each member was given an opportunity to double its subscription without any payment. Thus, for countries joining the IBRD after the 1959 capital increase and for those subscribing to additional capital stock, the statutory provisions affecting the 2% and 18% portions have been applied to only one-half of their total subscriptions, so that 1% of each subscription that is freely usable in the IBRD's operations has been payable in gold or US dollars, and 9% that is usable only with the consent of the member is in the member's currency. The remaining 90% is not paid in but is subject to call by the IBRD.

Financial Resources for Lending Purposes: The subscriptions of the IBRD's members constitute the basic element in the financial resources of the IBRD. Subscribed capital for fiscal year 2002 was about US $71.6 billion. The Bank also draws money from borrowings in the market and from earnings. In 2002, the Bank's outstanding borrowings were US $110.3 billion, raised in the capital markets of the world. The IBRD is able to raise large sums at interest rates little or no higher than are paid by governments because of confidence in the Bank engendered by its record of stability since 194 and the investors' knowledge that if the IBRD should ever be in difficulty, it can call in unpaid portions of member countries' subscriptions. In connection with its borrowing operations, the Bank also undertakes a substantial volume of currency and interest rate swap transactions. These swaps have enabled the IBRD to lower its fund-raising costs and to expand its direct borrowing transactions to markets and currencies in which it otherwise would not have borrowed.

B. Lending Operations: The IBRD lends to member governments, or, with government guarantee, to political subdivisions, or to public or private enterprises. The IBRD's first loan, US$ 250 million for postwar reconstruction, was made in the latter part of 194. Altogether, it lent US$ 49 million for postwar reconstruction, all to European countries. The IBRD's first development loans were made in the first half of 1948. As of 30 June 2002, the cumulative total of loans made by the Bank was over US$ 31 billion. The IBRD normally makes long-term loans, with repayment commencing after a certain period. The length of the loan is generally related to the estimated useful life of the equipment or plant being financed. Since July 1982, IBRD loans have been made at variable rates. The lending rate on all loans made under the variable-rate system is adjusted semiannually, on 1 January and 1 July, by adding a spread of 0.5% to the IBRD's weighted average cost during the prior six months of a "pool" of borrowings drawn down after 30 June 1982. Since July 1989, only borrowings allocated to lending have been included in the cost of borrowings with respect to new loans and existing variable rate loans that are amended to apply the new cost basis. For interest periods beginning from 1 July 2002 through 31 December 2002, the variable lending rate was 5.2%. Before July 1982, loans were made at fixed rates, and, accordingly, the semiannual interest-rate adjustments do not apply to payments made on these older loans.

C. Purposes of the Loans: The main purpose of the Bank's operations is to lend to developing member countries for productive projects in such sectors as agriculture, energy, industry, and transportation and to help improve basic services considered essential for development. The main criterion for assistance is that it should be provided where it can be most effective in the context of the country's specific lending programs developed by the Bank in consultation with its borrowers. In the late 1980s, the World Bank came under criticism that its policies, intended to encourage developing countries to restructure their economies in order to render them more efficient, were actually imposing too heavy a burden on the world's poorest peoples. This, and charges by environmentalists that World Bank lending had underwritten projects that were severely detrimental to the environment of developing countries, led to a re-thinking of the Bank's policies in the 1990s.

Implementing the Bank's Poverty Reduction Strategy: The fundamental objective of the World Bank is sustainable poverty reduction. Underpinning this objective is a two-part strategy for reducing poverty that was proposed in the World Development Report 1990.

- The first element is to promote broad-based economic growth that makes efficient use of the poor's most abundant asset, labor.
- The second element involves ensuring widespread access to basic social services to improve the well being of the poor and to enable them to participate fully in the growth of the economy. Progress in implementing the poverty-reduction strategy is clearly visible in Bank-wide statistics on new lending. At the September 1999 annual meetings of the World Bank Group and IMF, ministers agreed to link debt relief to the establishment of a poverty reduction strategy for all countries receiving World Bank/IMF concessional assistance.
- Sector and Structural Adjustment Lending. Bank lending for sector adjustment and structural adjustment increasingly supports the establishment of social safety nets and the protection of public spending for basic social services.

The Global Environment Facility is a cooperative venture between the World Bank, the United Nations Development Programme, the United Nations Environment Programme, and national governments. The Facility provides grants to help developing countries deal with environmental problems that transcend boundaries, such as airborne pollution produced by smokestacks or hazardous waste dumped into rivers. The GEF gives priority to four objectives: limiting emissions of greenhouse gases, preserving biodiversity, protecting international waters; and protecting the ozone layer.

Private Sector Development. The promotion of private sector growth in developing member countries has always been central to the Bank's overall mission of fostering sustainable growth and reducing poverty. In December 1999, the Bank Group announced a restructuring to better align and expand its work related to the private sector. The reforms took effect 1 January 2000. The reorganization tightened the link between the Bank's public sector work and its private sector transactions in the developing world, which are made through the IFC. The World Bank helps governments to formulate policy frameworks that encourage a positive environment for business to function as the primary engine of growth while the IFC, the private sector arm of the Bank Group, provides advice and makes loans and equity investments in companies in developing countries.

According to an IFC official the changes were in response to "one of the biggest challenges facing client countries: How to create a favorable business environment and help finance small and medium enterprises." In addition to creating a new combined unit to coordinate Bank Group activities, help capitalize local financial institutions, and teach them the business of financing small and medium enterprises, the restructuring also involved the creation of joint World Bank-IFC departments, or product groups, for industries where there is a strong interface between public policy and private sector transactions. Three new industry groups, telecommunications/informatics, oil/gas/petrochemicals, and mining, include both policy and transaction capacity. Beyond the new industry groups, the principal advisory services focused on the private sector in both the World Bank and IFC are coordinated under single management.

D. Other Activities

Technical Assistance: The Bank provides its members with a wide variety of technical assistance, much of it financed under its lending program. The volume of technical assistance in which the Bank is involved as lender, provider, or administrator rose sharply during the 1990s. In addition to loans and guarantees to developing countries, the World Bank carries out its mission by providing advice and assistance with telecommunications sector reform and national information infrastructure strategies. Special programs in this category include Info and TechNet. The Information for Development Program began in September 1995 with the objective of addressing the obstacles facing developing countries in an increasingly information-driven world economy.

Interagency Co operation: The Bank's overarching purpose is helping to reduce global poverty. To this end, the institution encourages the involvement of other development agencies in preparing poverty assessments and works closely with other UN agencies in preparing proposals to improve the quality of poverty-related data.

The Economic Development Institute was the Bank's department responsible for such dissemination. Through seminars, workshops and courses, EDI enabled policy-makers to assess and use the lessons of development to benefit their own policies. On 10 March 1999, the World Bank unveiled the successor to the EDI, the World Bank Institute (WBI). The new learning entity also absorbed the World Bank's Learning and Leadership Center. The WBI drives the Bank's learning agenda, working in three main areas: training, policy services, and knowledge networks. WBI is located at World Bank headquarters in Washington, DC.

19.5. IDA – INTERNATIONAL DEVELOPMENT AGENCY

This institution was established in 1960 and is known as a soft window for the World Bank. So, the primary function of this institution is to provide infrastructural support to the member nations. Thus, it provides the long term loans which are interest-free for the development of these economies. Also, these loans provide are known as credits. When you talk World Bank it refers to only IBRD and IDA. While for the World Bank group, it represents all the five organizations. The World’s International Development Agencies: An aid agency is an organization dedicated to distributing aid. Most developed countries manage their Overseas Development Assistance (ODA) contributions through a government body.

A list of the major National Development Agencies is below:

Australia – Australian Agency for International Development (AusAID)

Austria – Austrian Development Agency – ADA [www.ada.gv.at] The Austrian Development Cooperation[1], Austria Wirtschaftsservice Gesellschaft (aws) [2]

Belgium – Ministry of Foreign Affairs, Foreign Trade and Development: Belgian Policy Plan for Development Cooperation[3], Belgian Technical Cooperation – BTCCTB [4]

Brazil – Agência Brasileira de Cooperação
Canada – Canadian International Development Agency (CIDA) and International Development Research Centre (IDRC)
Chile – Agencia de Cooperación Internacional de Chile (AGCI)
Denmark – Danish International Development Agency (DANIDA)
Egypt – Egyptian Fund for Technical Cooperation with Africa (EFTCA)[5] and Egyptian Fund For Technical Cooperation with the Commonwealth[6]
European Union – EuropeAid Development and Cooperation[7]
Finland– Department for International Development Cooperation (FINIDA) [8]
France – Department for International Cooperation[9] and French Development Agency (AfD)
Germany – Federal Ministry for Economic Cooperation and Development, Kreditanstalt für Wiederaufbau (KfW), and Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ)
Greece – Ministry of Foreign Affairs
Iran – Organization for Investment, Economic, and Technical Assistance of Iran
Ireland – Irish Aid[10]
Israel – Ministry of Foreign Affairs: MASHAV – Israel's Agency for International Development Cooperation[11]
Italy – Ministry of Foreign Affairs: Italian Development Cooperation Programme [12]
Japan – Ministry of Foreign Affairs: Official Development Assistance [13], Japan International Cooperation Agency (JICA), and Japan Bank for International Cooperation (JBIC)
Korea – Korea International Cooperation Agency[14]
Kuwait – Kuwait Fund for Arab Economic Development [www.kuwait-fund.org]
Liechtenstein – Liechtensteinische Entwicklungsdienst [15]
Luxembourg – Lux-Development [16]
New Zealand – New Zealand Agency for International Development (NZAid)[17]
Netherlands – Ministry of Development Cooperation[18] (has its own minister but is a part of the Ministry of Foreign Affairs)
Norway – Ministry of Foreign Affairs: International Development Program [19] and Norwegian Agency for Development Cooperation (NORAD)
Poland – Ministry of Foreign Affairs: The Development Co-operation Department [20]
Portugal – Instituto Português de Apoio ao Desenvolvimento [21]
Republic of China (Taiwan) – International Cooperation and Development Fund (ICDF) [22]
Romania – Assistance for Development[23]
Saudi Arabia – Saudi Fund for Development
Slovakia – Slovak Aid[24]
Spain – Spanish Agency for International Development Cooperation (AECID)[25]
Sweden – Swedish International Development Cooperation Agency (Sida)
Switzerland – Swiss Agency for Development and Cooperation(SDC), Helvetas
Turkey – Turkish International Cooperation and Development AgencyTİKA) [26]
United Kingdom – Department for International Development (DFID)
United States – United States Agency for International Development(USAID) the Inter-American Foundation(IAF), and the Millennium Challenge Corporation (MCC) African Development Foundation (ADF)

19.6. MULTILATERAL INVESTMENT GUARANTEE AGENCY (MIGA)

This body of World Bank group was established in 1988. So, the primary objective is to encourage foreign investment in the member countries. Thus, it is done by offering insurance to foreign private investors against the loss due to political risks. The MIGA was established in 1988 to encourage equity investment and other direct investment flows to developing countries by offering investors a variety of different services. It offers guarantees against noncommercial risks; advises developing member governments on the design and implementation of policies, programmes and procedures related to foreign investments; and sponsors a dialogue between the international business community and host governments on investment issues.

Functions of Multilateral Investment Guarantee Agency (MIGA): MIGA is a member of the World Bank Group and membership is open to all World Bank members. The MIGA was created in 1988 to promote foreign direct investment into emerging economies to improve people's lives and reduce poverty. MIGA fulfills this mandate and contributes to development by offering political risk insurance to investors and lenders, and by helping developing countries attract and retain private investment. MIGA provides investment guarantees against non-commercial risks to eligible foreign investors for qualified investments in developing member countries. MIGA's coverage is against the following risks, transfer restriction, expropriation, breach of contract, war and civil disturbance. MIGA insures new cross-border investments originating in any MIGa member country, destined for other developing member country. Projects supported by MIGA have widespread benefits:

- Local jobs were created
- Tax revenue was generated - Skills and technological know-how were transferred.
- Local communities often receive significant secondary benefits through improved infrastructure, including roads, electricity, hospitals, schools and clean water.
- Foreign Direct Investment supported by MIGA also encourages similar local investments and spurs the growth of local businesses that supply related goods and services. As a result, developing countries have a greater chance to break the cycle of poverty.
- Since its inception MIGA has issued more than 500 guarantees for projects in 78 developing countries.
- The total coverage issued exceeds $9 billion, bringing the estimated amount of foreign direct investment facilitated since inception to more than $41 billion.
- MIGA's technical assistance services also play an integral role in catalyzing foreign direct investment by helping developing countries around the world define and implement strategies to promote investment.
- MIGA develops and deploys tools and technologies to support the spread of information on investment opportunities.
- The agency uses its legal services to further smooth possible impediments to investment. Through its dispute mediation program, MIGA helps government and investors resolve their differences and ultimately improve the country's investment climate.
- MIGA compliments the activities of other investment insurers and works with partners through its coinsurance and reinsurance programs to expand the capacity of the political risk insurance industry's income. To date, MIGA has officially established 18 such partnerships.

MIGA Strategy: MIGA's operational strategy plays to our foremost strength in the marketplace—attracting investors and private insurers into difficult operating environments. We focus on insuring investments in the areas where we can make the greatest difference-

Countries eligible for assistance from the International Development Association (the world's poorest countries)

Fragile and conflict-affected environments

Transformational Projects – large scale and significant investments, with the potential for bringing about transformational change in the host country

Energy Efficiency and Climate Change - complex energy and infrastructure projects that improve energy capacity as well as transportation projects that have a positive impact on pollution control (such as mass transport)

Middle Income Countries where we can have strong impact
MIGA offers comparative advantages in all of these areas—from our unique package of products and ability to restore the business community's confidence, to our ongoing collaboration with the public and private insurance market to increase the amount of insurance available to investors.
As a multilateral development agency, MIGA only supports investments that are developmentally sound and meet high social and environmental standards. MIGA applies a comprehensive set of social and environmental performance standards to all projects and offers extensive expertise in working with investors to ensure compliance to these standards.
ICSID – International Center for Settlement of Investment Disputes: This organization was established in 1966. It is the body that settles investment disputes. It is done for the parties binding to it. Furthermore, it settles the investment disputes between host countries and foreign companies when the investment is done.

19.7. SUMMARY

IFC is a member of the World Bank Group, which consists of five closely associated institutions that are owned by member countries. Each plays a distinct role in helping fight poverty and improve lives.IFC promotes economic development through private sector. Working with business partners, IFC invests in sustainable private enterprises in developing countries without the need for government guarantees. This direct lending to businesses is the fundamental contrast between IFC and the World Bank: under their Articles of Agreement, IBRD and IDA can only lend to the governments of member countries. IFC was founded specifically to address this limitation in World Bank lending.IFC also offers advisory services to support private sector development. Most of these activities are funded in partnership with donor countries; many involve close collaboration with the World Bank. Toward this common objective, the World Bank, IDA and IFC have three inter related functions and these are to lend funds, to provide advice and to serve as a catalyst in order to stimulate investments by others. All three organizations have the same central goals: to promote economic and social progress in poor or developing countries by helping raise standards of living and productivity to the point at which development becomes self-sustaining.

19.8. TECHNICAL TERMS

World Bank: The World Bank is an international organization dedicated to providing financing, advice, and research to developing nations to aid their economic advancement. The bank predominantly acts as an organization that attempts to fight poverty by offering developmental assistance to middle- and low-income countries.

IFC: The International Finance Corporation (IFC) is an international financial institution that offers investment, advisory, and asset-management services to encourage private-sector development in less developed countries. The IFC is a member of the World Bank Group and is headquartered in Washington, D.C.

IDA: The World Bank’s International Development Association (IDA) is one of the largest and most effective platforms for fighting extreme poverty in the world’s lowest income countries. IDA works in 74 countries in Africa, East Asia & Pacific, South Asia, Europe & Central Asia, Latin America & Caribbean, and Middle East & North Africa. International Development Association: An aid agency is an organization dedicated to distributing aid.

Most developed countries manage their Overseas Development Assistance (ODA) contributions through a government body.

IBRD: The International Bank for Reconstruction and Development (IBRD) is a global development cooperative owned by 189 member countries. As the largest development bank in the world, it supports the World Bank Group's mission by providing loans, guarantees, risk management products, and advisory services to middle-income and creditworthy low-income countries, as well as by coordinating responses to regional and global challenges.

19.9. SELF ASSESSMENT QUESTIONS

1. Explain about International Finance Corporation, objectives and its functions**?**
2. Explain, International Development Association (I.D.A.)?
3. What do you know about International Development Agency (IDA)
4. Discuss about International Bank for Reconstruction and Development (IBRD)
5. What is Multilateral Investment Guarantee Agency (MIGA)

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LESSON-20
BRICKS & NEW DEVELOPMENT BANK

AIMS AND OBJECTIVES

After reading this lesson, you should be able to

- Know about History & Developments of BRICS
- Awareness regarding BRIC summits, Current leaders & Current ministerial leaders
- Understand about BRICS New Development Bank

STRUCTURE

20.1. INTRODUCTION

BRICS is an acronym for five leading emerging economies**:** Brazil, Russia, India, China, and South Africa. The first four were initially grouped as "BRIC" (or "the BRICs") in 2001 by Goldman Sachs economist Jim O'Neill, who coined the term to describe fast-growing economies that would collectively dominate the global economy by 2050; South Africa was added in 2010. The BRICS have a combined area of 39,746,220 km2 (15,346,100 sq mi) and an estimated total population of about 3.21 billion, or about 26.7% of the world's land surface and 41.5% of the global population. Brazil, Russia, India, and China are among the world's ten largest countries by population, area, and GDP, and the latter three are widely considered to be current or emerging superpowers. All five states are members of the G20, with a combined nominal GDP of US$26.6 trillion (about 26.2% of the gross world product), a total GDP (PPP) of around US$51.99 trillion (32.1% of global GDP PPP), and an estimated US$4.46 trillion in combined foreign reserves (as of 2018). The term BRIC was originally developed in the context of foreign investment strategies. It was introduced in the 2001 publication, *Building Better Global Economic BRICs* by then-chairman of Goldman Sachs Asset Management, Jim O'Neill;[12] the term was coined by Roopa Purushothaman, who was a Research Assistant in the original report.[13] For investing purposes, the list of emerging economies sometimes included South Korea, which expanded the acronym to BRICS or BRICK.

Member countries: Bangladesh, Egypt, the United Arab Emirates and Uruguay are members of BRICS New Development Bank.

The BRICS were originally identified for the purpose of highlighting investment opportunities and had not been a formal intergovernmental organization.[6] Since 2009, they have increasingly formed into a more cohesive geopolitical bloc, with their governments meeting annually at formal summits and coordinating multilateral policies; China hosted the most recent 14th BRICS summit on 24 July 2022. Bilateral relations among the BRICS are conducted mainly on the basis of non-interference, equality, and mutual benefit.

The BRICS are considered the foremost rival to the G7 bloc of leading advanced economies,[1] announcing competing initiatives such as the New Development Bank, Contingent Reserve Arrangement, BRICS payment system, and BRICS basket reserve currency. Since 2022, the group has sought to expand membership, with several developing countries expressing interest in joining.[8] The BRICS have received both praise and criticism from numerous commentators.[9][10][11]

20.2. DEVELOPMENT OF BRICS

The foreign ministers of the initial four BRIC General states (Brazil, Russia, India, and China) met in New York City in September 2006 at the margins of the General Debate of the UN Assembly, beginning a series of high-level meetings.[14] A full-scale diplomatic meeting was held in Yekaterinburg, Russia, on 16 June 2009.[15] The BRIC grouping's 1st formal summit, also held in Yekaterinburg, commenced on 16 June 2009,[16] with Luiz Inácio Lula da Silva, Dmitry Medvedev, Manmohan Singh, and Hu Jintao, the respective leaders of Brazil, Russia, India, and China, all attending.[17] The summit's focus was on improving the global economic situation and reforming financial institutions, and discussed how the four countries could better co-operate in the future.[16][17] There was further discussion of ways that developing countries, such as 3/4 of the BRIC members, could become more involved in global affairs.[17] In the aftermath of the Yekaterinburg summit, the BRIC nations announced the need for a new global reserve currency, which would have to be "diverse, stable and predictable."[18] Although the statement that was released did not directly criticize the perceived "dominance" of the US dollar – something that Russia had criticized in the past – it did spark a fall in the value of the dollar against other major currencies.[19]

i. Entry of South Africa

In 2010, South Africa began efforts to join the BRIC grouping, and the process for its formal admission began in August of that year.[20] South Africa officially became a member nation on 24 December 2010, after being formally invited by China to join[21] and subsequently accepted by other BRIC countries.[20] The group was renamed BRICS – with the "S" standing for South Africa – to reflect the group's expanded membership.[22] In April 2011, the President of South Africa, Jacob Zuma, attended the 2011 BRICS summit in Sanya, China, as a full member.[23][24][25]

ii. Membership expansion proposals: Discussions about the expansion and entry of new member countries were little addressed until the early 2020s, after this date, leaders and top ranking diplomats of the founding nations began discussions for the expansion of the group.[76][77][78] Algeria, Argentina, Bahrain,Bangladesh, Belarus,Egypt, Indonesia, Iran, Mexico, Nigeria, Pakistan, SaudiArabia, Sudan, Syria, Turkey,theUAE, Venezuela and Zimbabwe have expressed interest in membership of BRICS. On 16 March 2023, Russia announced that it supported Algeria's bid to join BRICS.[83]

iii. Applicant nations: Algeria applied in 2022[78] Argentina applied in 2022[78] Iran applied in 2022[78]

iv. Nations interested in membership: Afghanistan[76] Egypt[76] Indonesia[76]\ Saudi Arabia[76] Syria[76] Turkey[76]

v. BRICS Expansion Dialogue participant nations: Kazakhstan[77] Nicaragua[77 Nigeria[77]\ Senegal[77] Thailand[77] United Arab Emirates

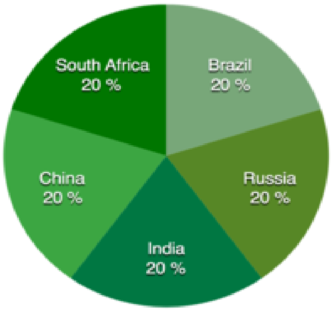
vi. Potential further expansion

Since South Africa joined the BRIC grouping (now BRICS) in 2010, numerous other countries have expressed interest in joining the bloc, including Argentina and Iran. Both signaled their intent to join BRICS during meetings with senior Chinese officials, the current BRICS chair, over the course of the summer of 2022. Beijing backed Argentina's potential accession[26] following a meeting[27] between Argentine Foreign Minister Santiago Cafiero and Chinese State Councilor and Foreign Minister Wang Yi on the margins of the G20 Summit in Indonesia. China once again reiterated their support for Argentina's potential application during a subsequent meeting between Cafiero and Yi on the margins of the 77th UN General Assembly.[26] Likewise, it is understood that both Russia, India, and Brazil support Argentina's application. Iran also submitted an application in June 2022 to Chinese authorities to join the economic association of emerging markets.[28] Relations between Iran, China and Russia have warmed in recent months as all three governments seek new allies against increasing Western opposition. There is no formal application process as such to join BRICS, but any hopeful government must receive unanimous backing from all existing BRICS members—Brazil, Russia, India, China, and South Africa—to receive an invitation.

vii. BRICS Tower headquarters in Shanghai

In July 2014, the Governor of the Russian Central Bank, Elvira Nabiullina, claimed that the "BRICS partners promote the establishment of a system of multilateral swaps that will allow them to transfer resources to one or another country if needed" in an article which concluded that "If the current trend continues, soon the dollar will be abandoned by most of the significant global economies and it will be kicked out of the global trade finance."[38]

Financial architecture



viii. BRICS Developments: Brazilian president Jair Bolsonaro and Russian president Vladimir Putin during the BRICS in Brasília, Brazil. The BRICS Forum, an independent international organization encouraging commercial, political, and cultural cooperation among the BRICS nations, was formed in 2011.[29] In June 2012, the BRICS nations pledged $75 billion to boost the lending power of the International Monetary Fund (IMF). However, this loan was conditional on IMF voting reforms.[30] In late March 2013, during the fifth BRICS summit in Durban, South Africa, the member countries agreed to create a global financial institution intended to cooperate with the western-dominated IMF and World Bank.[31] After the summit, the BRICS stated that they planned to finalize the arrangements for this New Development Bank by 2014.[32] However, disputes relating to burden sharing and location slowed down the agreements. At the BRICS leaders meeting in St Petersburg in September 2013, China committed $41 billion towards the pool; Brazil, India, and Russia $18 billion each; and South Africa $5 billion. China, holder of the world's largest foreign exchange reserves and contributes the bulk of the currency pool, wants a more significant managing role, said one BRICS official. China also wants to be the location of the reserve. "Brazil and India want the initial capital to be shared equally. We know that China wants more," said a Brazilian official. "However, we are still negotiating, there are no tensions arising yet."[33] On 11 October 2013,

ix. Russia's Finance Minister Anton Siluanov: Russia's Finance Minister Anton Siluanov said that creating a $100 billion in funds designated to steady currency markets would be taken in early 2014. The Brazilian finance minister, Guido Mantega, stated that the fund would be created by March 2014.[34] However, by April 2014, the currency reserve pool and development bank had yet to be set up, and the date was rescheduled to 2015.[35] One driver for the BRICS development bank is that the existing institutions primarily benefit extra-BRICS corporations, and the political significance is notable because it allows BRICS member states "to promote their interests abroad... and can highlight the strengthening positions of countries whose opinion is frequently ignored by their developed American and European colleagues."

x. BRICS Foreign Ministers issued a Communique : In March 2014, at a meeting on the margins of the Nuclear Security Summit in The Hague, the BRICS Foreign Ministers issued a communique that "noted with concern, the recent media statement on the forthcoming G20 Summit to be held in Brisbane in November 2014. The custodianship of the G20 belongs to all Member States equally, and no one Member State can unilaterally determine its nature and character." In light of the tensions surrounding the annexation of Ukrainian Crimea by Russia, the Ministers remarked that "The escalation of hostile language, sanctions and counter-sanctions, and force does not contribute to a sustainable and peaceful solution, according to international law, including the principles and purposes of the United Nations Charter."[36] This was in response to the statement of the then Australian Foreign Minister Julie Bishop, who had said earlier that Russian President Vladimir Putin might be barred from attending the G20 Summit in Brisbane.[37]

20.3. BRICS SUMMITS

The grouping has held annual summits since 2009, with member countries taking turns to host. Prior to South Africa's admission, two BRIC summits were held, in 2009 and 2010. The first five-member BRICS summit was held in 2011. The most recent BRICS leaders' summit took place virtually on 23 June 2022 hosted by China.[50][51] India has hosted the BRICS 2021 summit at New Delhi & amid tensions with China, Chinese leader Xi Jinping had made a soft move by supporting India's Chairmanship in 2021.

Table : BRICCS Summits: The grouping has held annual summits since 2009

Sr. No.	Date	Host country	Host leader	Location	Notes
1st	16 June 2009	Russia	Dmitry Medvedev	Yekaterinburg (Sevastianov's House)	The summit was to discuss the global recession taking place at the time, future cooperation among states, and trade. Some of the specific topics discussed were food, trade, climate trade, and security for the nations. They called out for a more influential voice and representation for up-and-coming markets. Note at the time South Africa was not yet admitted to the BRICS organization at the time.[53]
2nd	15 April 2010	Brazil	Luiz Inácio Lula da Silva	Brasília (Itamaraty Palace)	Guests: Jacob Zuma (President of South Africa) and Riyad al-Maliki (Foreign Minister of the Palestinian National Authority). The second summit continued on the conversation of the global recession and how to recover. They had a conversation on the IMF, climate change, and more ways to form cooperation among states.[53]

3rd	14 April 2011	China	Hu Jintao	Sanya (Sheraton Sanya Resort)	First summit to include South Africa alongside the original BRIC countries. The third summit had nations debating on the global and internal economies of countries.[53]
4th	29 March 2012	India	Manmohan Singh	New Delhi (Taj Mahal Hotel)	The BRICS Cable announced an optical fibre submarine communications cable system that carries telecommunications between the BRICS countries. The fourth summit discussed how the organization could prosper from the global recession and how they could take advantage of that to help their economies. BRICS had the intention of improving their global power and providing adequate development for their state.[54]
5th	26–27 March 2013	South Africa	Jacob Zuma	Durban (Durban ICC)	The fifth summit discusses the New Development Bank proposition and Contingent Reserve Agreement. BRICS also announced the Business Council and its Think Tank Council.[54]
6th	14–17 July 2014	Brazil	Dilma Rousseff	Fortaleza (Centro de Eventos do Ceará)[55]	BRICS New Development Bank and BRICS Contingent Reserve Arrangement agreements signed. Guest: Leaders of Union of South American Nations (UNASUR)[56][57] The members of BRICS conversed with each other about political coordination, development, and economic growth. They established the Fortaleza Declaration and Action Plan.[58]
7th	8–9 July 2015	Russia	Vladimir Putin	Ufa (Congress Hall)[59]	Joint summit with SCO-EAEU. The seventh summit discussed global, economic problems, and better ways to foster cooperation among member states.[58]
8th	15–16 October 2016	India	Narendra Modi	Benaulim (Taj Exotica)	Joint summit with BIMSTEC. The eighth BRICS summit debated on topics like counter-terrorism, economies, and climate change. BRICS also issued the Goa Declaration and Action Plan, hoping

					to harden their relationships.[60]
9th	3–5 September 2017	China	Xi Jinping	Xiamen (Xiamen International Conference Center)	Joint summit with EMDCD. The ninth summit was an event that talked about a bright future for BRICS and what their goals intend to be. They still covered and debated international and regional issues with one another; hopeful to keep moving forward.[60]
10th	25–27 July 2018	South Africa	Cyril Ramaphosa	Johannesburg (Sandton Convention Centre)	The tenth summit had the members discuss their rising industries. Hoping they can cut a bigger slice of the industry market.
11th	13–14 November 2019	Brazil	Jair Bolsonaro	Brasília (Itamaraty Palace)[52]	The eleventh summit discussed advancements in the BRICS's science and innovation fields. Primarily trying to advance technology and digital currency. They made mutual agreements to help stop drug trafficking and organized crime; both internationally and internally
12th	21–23 July 2020 7 November 2020	Russia	Vladimir Putin	Saint Petersburg[63]	(video conference) Joint summit with SCO. Discussing a mutual agreement on helping BRICS member countries to help foster better living standards and quality of life for each country's people. Plans on focusing on peace, economies, and cultural societal issues.[64]
13th	9 September 2021	India	Narendra Modi	New Delhi	(video conference) BRICS Games 2021[65]
14th	23 June 2022	China	Xi Jinping	Beijing	(video conference)
15th	August 2023	South Africa		Durban	

20.4. THE BRICS CONTINGENT RESERVE ARRANGEMENT (CRA)

BRICS CRA is a framework for providing protection against global liquidity pressures.[85][88][91] This includes currency issues where members' national currencies are being adversely affected by global financial pressures.[85][91] It is found that emerging economies that experienced rapid economic liberalization went through increased economic volatility, bringing an uncertain macroeconomic environment.[92] The CRA is generally seen as a competitor to the International Monetary Fund (IMF) and along with the New Development Bank is viewed as an example of increasing South-South cooperation.[85] It was established in 2015 by the BRICS countries. The legal basis is formed by the *Treaty for the Establishment of a BRICS Contingent Reserve Arrangement*, signed at Fortaleza, Brazil on 15 July 2014. With its inaugural meetings of the BRICS CRA Governing Council and Standing Committee, held on 4 September 2015, in Ankara, Turkey[93] it entered into force upon ratification by all BRICS states, announced at the 7th BRICS summit in July 2015.

i. BRICS payment system: At the 2015 BRICS summit in Russia, ministers from BRICS nations, initiated consultations for a payment system that would be an alternative to the Society for Worldwide Interbank Financial Telecommunication (SWIFT) system. Russian Deputy Foreign Minister Sergey Ryabkov stated in an interview, "The finance ministers and executives of the BRICS central banks are negotiating ... setting up payment systems and moving on to settlements in national currencies. SWIFT or not, in any case we're talking about ... a global multilateral payment system that would provide greater independence, would create a definite guarantee for BRICS.". The Central Bank of Russia (CBR) also started consultations with BRICS nations for a payment system that would be an alternative to the SWIFT system. The main benefits highlighted were backup and redundancy in case there were disruptions to the SWIFT system. The Deputy Governor of the Central Bank of Russia, Olga Skorobogatova, stated in an interview, "The only topic that may be of interest to all of us within BRICS is to consider and talk over the possibility of setting up a system that would apply to the BRICS countries, used as a backup.". China has also initiated the development of their own SWIFT-alternative payment-system called the Cross-Border Inter-Bank Payments System (CIPS), which would provide a network that enables financial institutions worldwide to send and receive information about financial transactions in a secure, standardized, and reliable environment.[96] India also has its alternative Structured Financial Messaging System (SFMS), as does Russia with its Система передачи финансовых сообщений (СПФС)/System for Transfer of Financial Messages (SPFS).
On 9 April 2013, Isobel Coleman from the Council on Foreign Relations, director of CFR's Civil Society, Markets, and Democracy Program said that members of BRICS share a lack of consensus. They uphold drastically different political systems, from a vibrant democracy in Brazil to entrenched oligarchy in Russia, and their economies are little integrated and are different in size by orders of magnitude. Also, she states that the significant difference in GDP influences the reserves. China taking up over 41% of the contribution, which in turn leads to bigger political say within the association.[103]. Vijay Prashad, author and the Edward Said Chair at the American University of Beirut, 2014 raised the BRICS limitations as a political and economic "locomotive of the South" because they follow neoliberal policies. They have established neither new counter-balancing institutions nor come up with an alternative ideology. Furthermore, the BRICS project, argues Prashad, has no ability to challenge the primacy of the United States and NATO.[104]

20.5. BRICS PRO TEMPORE PRESIDENCY

The group at each summit elects one of the heads of state of the component countries to serve as President Pro Tempore of the BRICS. In 2019, the pro tempore presidency was held by the president of Brazil.[105]. The theme of the 11th BRICS summit was "BRICS: economic growth for an innovative future", and the priorities of the Brazilian Pro Tempore Presidency for 2019 are the following -Strengthening of the cooperation in Science, technology and innovation; Enhancement of the cooperation on digital economy; Invigoration of the cooperation on the fight against transnational crime, especially against organized crime, money laundering and drug trafficking; Encouragement to the rapprochement between the New Development Bank (NDB) and the BRICS Business Council.[106] Currently the new President Pro Tempore is Russia and their goals are: investing into BRICS countries in order to strengthen everyone's economies, cooperating in the energy and environmental

Current leaders:

Member	Image	Name	Position(s)
Brazil		Luiz Inácio Lula da Silva	President of Brazil
China		Xi Jinping	General Secretary of the Chinese Communist Party President of China
India		Narendra Modi	Prime Minister of India
Russia		Vladimir Putin	President of Russia
South Africa		Cyril Ramaphosa	President of South Africa

industries, helping with young children and coming up with resolutions on migration and peacekeeping.[107]

Current ministerial leaders:

Member	Foreign minister	Name	Finance minister	Name	Central bank governor
Brazil	Minister of Foreign Affairs	Mauro Vieira	Minister of Finance	Fernando Haddad	Roberto Campos Neto
China	Minister of Foreign Affairs	Qin Gang	Minister of Finance	Liu Kun	Yi Gang
India	Minister of External Affairs	Subrahmanyam Jaishankar	Minister of Finance	Nirmala Sitharaman	Shaktikanta Das
Russia	Minister of Foreign Affairs	Sergei Lavrov	Minister of Finance	Anton Siluanov	Elvira Nabiullina
South Africa	Minister of International Relations and Cooperation	Naledi Pandor	Minister of Finance	Enoch Godongwana	Lesetja Kganyago

20.6. BRICS NEW DEVELOLPMENT BANK

The New Development Bank (NDB) is based in Shanghai. The New Development Bank (NDB) and Contingent Reserve Arrangement (CRA) were signed into treaty at the 2014 BRICS summit in Brazil. Equal distribution of shares between the shareholders of the NDB. Currently, there are two components that make up the financial architecture of BRICS, namely, the New Development Bank (NDB), or sometimes referred to as the BRICS Development Bank, and the Contingent Reserve Arrangement (CRA). Both of these components were signed into treaty in 2014 and became active in 2015.

The **New** Development Bank (NDB), formally referred to as the BRICS Development Bank, is a multilateral development bank operated by the five BRICS states. The bank's primary focus of lending will be infrastructure projects[85][86] with authorized lending of up to $34 billion annually.[86] South Africa will be the African Headquarters of the Bank named the "New Development Bank Africa Regional Centre."[87] The bank will have starting capital of $50 billion, with wealth increased to $100 billion over time.[88] Brazil, Russia, India, China, and South Africa will initially contribute $10 billion each to bring the total to $50 billion.[87][88] It has so far 53 projects under way worth around $15 billion.9] Recently Bangladesh, Egypt, the United Arab Emirates and Uruguay were added as new members of BRICS New Development Bank (NDB).[90] The NDB is a multilateral financial institution established by the BRICS countries, namely, Brazil, Russia, India, China and South Africa. The purpose of NDB is to fund sustainable development projects and infrastructure projects in the BRICS countries and other developing countries and emerging markets. Recently, during BRICS (Brazil, Russia, India, China and South Africa) meet, India proposed that NDB's (New Development Bank) scope be expanded to strengthen Social Infrastructure besides promoting industry.

20.6.1. Objectives of BRICS New Development Bank:

i. Fostering development of member countries.

ii. Supporting economic growth.

iii. Promoting competitiveness and facilitating job creation.

iv. Building a knowledge sharing platform among developing countries.

v. To fulfill its purpose, the Bank supports public or private projects through loans, guarantees, equity participation and other financial instruments.

20.6.2. Functions of BRICS New Development Bank: The broad objectives and functions of NDB are:

i. Fostering development of member countries, Supporting economic growth

ii. Promoting competitiveness and facilitating job creation

iii. Building a knowledge sharing platform among developing countries

20.6.3 New Development Bank's logo: After the 2015 summit, the respective communications ministers, under a Russian proposal, had a first summit for their ministries in Moscow in October where the host minister, Nikolai Nikiforov, proposed an initiative to further tighten their information technology sectors and challenge the monopoly of the United States in the sector.


Since 2012, the BRICS group of countries have been planning an optical fibre submarine communications cable system to carry telecommunications between the BRICS countries, known as the BRICS Cable.[44] Part of the motivation for the project was the spying of the U.S. National Security Agency on all telecommunications that flowed in and out of United States territory.[45]. In August 2019, the communications ministers of the BRICS countries signed a letter of intent to cooperate in the Information and Communication Technology sector. This agreement was signed in the fifth edition of meeting of communication ministers of countries member of the group[46] held in Brasília, Brazil.

20.6.4. The New Development Bank, located in China: The New Development Bank, located in China, plans on giving out $15 billion to member nation to help their struggling economies. Member countries are hoping for a smooth comeback and a continuation of economic trade pre-COVID-19. The summit they plan on doing virtually in St. Petersburg, Russia will discuss how to handle the COVID-19 pandemic and how to fix their multilateral system by reforms.[47] The COVID-19 accepting rate of taking the vaccine is a mixture in the BRICS community. China, India, and South Africa are the most willing to take the vaccine while Brazil and Russia have more skepticism than the other three.[48] During the 13th BRICS summit, Indian Prime Minister Narendra Modi called for a transparent investigation into the origins of COVID-19 under the World Health Organization with the full cooperation of "all countries", and Chinese leader Xi Jinping spoke directly afterwards, calling on BRICS countries to "oppose politicisation" of the process.[49]

i. Social Infrastructure includes the construction and maintenance of facilities that support social services such as healthcare, education, and housing.

ii. India is the chair of the BRICS grouping for 2021.

iii. New Development Bank updates: NDB enters 2022 in expansion mode Development bank established by BRICS approved the admission of Bangladesh, Egypt, UAE and Uruguay
iv. SHANGHAI, Jan. 13, 2022 /PRNewswire/ -- The New Development Bank (NDB) – established by BRICS (Brazil, Russia, India, China and South Africa) – is starting 2022 in expansion mode after welcoming four new members in the previous year.
v. NDB was created in 2015 with the aim of becoming a global development bank to mobilize resources for infrastructure and sustainable development. During its first years of operation, the Bank focused on building solid foundations to operate at scale. After the initial establishment phase, NDB has now started admitting new members.
vi. NDB's Board of Governors authorized the Bank to conduct formal negotiations with prospective members in late 2020. After a round of successful negotiations, NDB has admitted four new members in 2021: Bangladesh, Egypt, the United Arab Emirates (UAE) and Uruguay.
vii. "We are delighted to welcome Bangladesh, Egypt, UAE and Uruguay to the NDB. They bring over 280 million people that can benefit from NDB's investments in infrastructure and sustainable development", said Mr. Marcos Troyjo, President of NDB. "We will continue to expand the Bank's membership in a gradual and balanced manner".
viii. NDB's membership expansion is in line with the Bank's strategy to be positioned as the premier development institution for emerging economies and developing countries.
ix. Since the beginning of its operations, NDB approved about 80 projects in all of its members, totaling a portfolio of US$ 30 billion. Projects in areas such as transport, water and sanitation, clean energy, digital infrastructure, social infrastructure and urban development are within the scope of the Bank.

20.7. SUMMARY

The term BRIC was originally developed in the context of foreign investment strategies. It was introduced in the 2001 publication, Building Better Global Economic BRICs by then-chairman of Goldman Sachs Asset Management, Jim O'Neill;[12] the term was coined by Roopa Purushothaman, who was a Research Assistant in the original report.[13] For investing purposes, the list of emerging economies sometimes included South Korea, which expanded the acronym to BRICS or BRICK. Member countries: Bangladesh, Egypt, the United Arab Emirates and Uruguay are members of BRICS New Development Bank.The NDB is a multilateral financial institution established by the BRICS countries, namely, Brazil, Russia, India, China and South Africa. The purpose of NDB is to fund sustainable development projects and infrastructure projects in the BRICS countries and other developing countries and emerging markets. Recently, during BRICS meet, India proposed that NDB’s (New Development Bank) scope be expanded to strengthen Social Infrastructure besides promoting industry and sustainable development projects in BRICS and other emerging economies and developing countries, complementing the existing efforts of multilateral and regional financial institutions for global growth and development. NDB has an authorized capital of US$ 100 billion, which is open for subscription by members of the United Nations.

20.8. TECHNICAL TERMS

Global Economy: The world economy or global economy is the economy of all humans of the world, referring to the global economic system, which includes all economic activities which are conducted both within and between nations, including production, consumption, economic management, work in general, exchange of financial values and trade of goods and services. In some contexts, the two terms are distinct "international" or "global economy" being measured separately

Asset Management: Asset management is the practice of increasing total wealth over time by acquiring, Asset management professionals perform this service for others. They may also the goal of asset management is to maximize the value of an investment portfolio. Asset management as a service is offered by financial institutions cater New Development Bank: The New Development Bank (NDB), formerly referred to as the BRICS Development Bank, is a multilateral development bank established by the BRICS states (Brazil, Russia, India, China and South Africa). According to the Agreement on the NDB, "the Bank shall support public or private projects through loans, guarantees, equity participation and other financial instruments Global growth**:** Global Growth has a diversified portfolio of services in the healthcare industry. We are working towards making health systems work better by building stronger, higher-quality health systems that are sustainable for the long term.

20.9. SELF ASSESSMENT QUESTIONS

1. Explain the History & Developments of BRICS
2. Briefly discuss about BRIC summits
3. Who are the Current leaders & Current ministerial leaders of BRICS.?
4. What are the Objectives and Functions of BRICS New Development Bank?

20.10. SUGGESTED READINGS

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Dr. Krishna Banana

MODEL QUESTION PAPER

INTERNATIONAL BANKING

Max. Marks: 70 **Time: 3 hrs.**

SECTION A (Total: 5x3=15 Marks)

(Answer the following questions. Each answer carries 3 marks)

1. a) Origin of BOE (OR) b) Money market
2. a) USA Money market (OR) b) New York Money market

3. a) European Central Bank functions (OR) b) Bank of Japan structure

4. a) Failures of RBI (OR) b) NABARD

5. a) IDA (OR) b) BRICKS

SECTION B (Total: 5x8 = 40 Marks)

(Answer the following questions. Each answer carries 8 marks)

6 a) Explain about Growth of Bank of England. (or)
b) Discuss briefly about English Banking System.

7. a) What is Federal Reserve System? Explain its working conditions. (or)
b) Discuss about Origin and Growth of Unit Banking

8. a) What is European Central Bank,? Discuss about its Functions (or)
b) Discuss about the Industrial Banking in Japan.

9. a) Explain about the monetary and credit policy of Reserve Bank of India, (or)
b) Briefly explain Indian money market

10. a) Expand IMF and briefly discussed about it.
b) Expand IBRD and briefly discussed about it.

SECTION C (Total: 1x15 =15 Marks)

11. a) Expand IDA and discussed about it. (or)
b) What is the importance of NABARD?