

Preface

With the publication of this fourth volume, the history of the Reserve Bank of India has been brought forward to the end of 1997. The institutional history of the Reserve Bank was first published in 1970, covering the period from 1935 to 1951, *i.e.*, the formative years. The volume traced the process for setting-up a central bank in India preceding the establishment of the Reserve Bank in 1935 as a shareholders' Bank until its nationalisation in 1949. The Bank's pioneering initiatives and efforts towards policy planning and institution building were in focus in Volume 2 that captured the evolution of the Reserve Bank from 1951 to 1967. This period was marked by the initiation of planned economic development in India with the launch of Five Year Plans. Volume 3, covering the period 1967 to 1981, traced developments in the vast expanse of the financial landscape in India. It also highlighted the realignment of financial and regulatory policies, bringing into sharp focus the bank nationalisation of 1969.

As the monetary authority and a regulatory and development institution performing diversified functions in the area of public policy, the activities and performance of the Reserve Bank are shaped and influenced both by the economic environment and the dominant central banking paradigm of the time. As is well-known, the period of 1981–1997 marks a very eventful phase in Indian economic history in terms of crises and structural changes. Considering that 1991 represented a major shift in economic and financial policies following the balance of payments crisis, the institutional history falls naturally into two distinct phases. The first phase, covering the period 1981–1989, deals with post-1981 developments in monetary policy and macroeconomic reforms. It is titled 'Consolidation

and Early Liberalisation’. The second phase covering the period 1989–1997 is titled ‘Crisis and Reforms’.

The decade of the 1980s remained broadly as the continuation of a mostly inward-looking, planned and administered era of central direction, though several initial attempts were made at liberalising certain segments of the economy. During this period, the country faced many uncertainties including, *inter alia*, a severe drought in 1987, causing supply constraints; erosion in the profitability of banks on the back of the introduction of populist political measures such as the loan *melas*, which engaged the attention of the Reserve Bank towards safety and prudential issues in the commercial banking system; administered interest rates that limited the scope of transmission and efficacy of monetary policy besides the fiscal dominance that further constrained manoeuvrability of monetary policy actions; and the fixed exchange rate regime with limited external sector opening up, leading to build-up of external imbalances.

There were, however, attempts at creating a systematic institutional infrastructure for rural credit with the creation of NABARD, which began operations in 1982. There were attempts to develop financial markets particularly the money market, since the mid-1980s. In parallel, capital market development received a thrust with the setting-up of the Securities and Exchange Board of India. The Committee to Review Working of the Monetary System (Chairman: Prof Sukhamoy Chakravarty, 1985) transformed the policy paradigm with respect to the objectives of monetary policy, regulation over money and credit, interest rate policies and co-ordination of monetary and fiscal policies.

The developments during the 1980s, however, clearly lacked an overarching framework for structural reforms and experienced political uncertainty towards the end of the decade that led to the emergence of macroeconomic distortions culminating in the balance of payments crisis of 1991. The period was characterised by continuous dialogue between the Reserve Bank of India and the Government over reining in fiscal deficit.

The second phase of the volume starts with circumstances, including domestic political developments, leading to the build-up of the balance of payments crisis. The turn of the decade of the 1990s was marked by several uncertainties. The country was grappling with fragile economic circumstances, compounded by an unsure political environment that called for firm policy actions. India thus faced an unprecedented balance of payments crisis in 1991. There was a challenge confronting the economy on the fiscal front. The pressure on external and internal resources posed

a challenge to monetary management and hindered investment. The need of the hour was fiscal correction, monetary stability, inflation control and regaining export competitiveness.

The comprehensive economic reforms, mostly home-grown, that were launched in 1991 with support from multilateral institutions and implemented in a gradual and cautious manner enabled India to gain international credibility. The devaluation of the rupee in 1991 gave a fillip to exports. This, combined with wide-ranging liberalisation efforts in various sectors, helped rather quickly to restore macroeconomic balance in the economy. Policy measures such as the institution of the Liberalised Exchange Rate Management System as a prelude to current account convertibility in 1994, the switch from direct to indirect instruments to improve the efficacy of monetary policy and developing financial markets for greater market integration facilitated the smooth transition of the economy towards a more dynamic and liberal regime.

The implementation of the recommendations of the Narasimham Committee Report (1991) for financial sector reforms was an important part of this transition. Another landmark was the Reserve Bank gaining a certain degree of autonomy and greater space for monetary operations after the agreement with the Government in 1994 to phase out the system of *ad hoc* Treasury Bills and automatic and unlimited monetisation of fiscal deficits effective April 1, 1997. On the regulatory front, attempts at consolidation in commercial banking and the strengthening of supervision in the non-banking segment were in focus during the 1990s.

All these developments have been captured against the backdrop of the organisational evolution of the Reserve Bank. The operations of the Bank emerged out of a diversity of roles entrusted to it and were marked by flexibility enabling the Bank to address the constraints of time. The changes in the composition of the Reserve Bank, signifying its structural transformation, have been woven with its functional progression, since the Reserve Bank was called upon to play a unique role to address the challenges posed by the circumstances. Alongside, there was recognition that central bank communication was an issue that needed to be addressed.

As regards the preparation of the current volume of Reserve Bank history, the primary responsibility for drafting the chapters has been that of Dr N. Gopalaswamy, Dr T.V. Gopalakrishnan and Shri Sudhakar Mohanty, all Consultants, and Gunjeet Kaur, Director, who did a commendable and painstaking job of drafting after sourcing, collecting and collating the relevant information and data. Shri K. Kanagasabapathy

focused on editing the chapters to maintain consistency, besides bringing in interesting insights into several historical episodes. Shri TCA Srinivasa Raghavan also provided editorial support during his brief association with the project at the initial stage.

An internal team of officers comprising Jaya Mohanty, Director; Rajiv Jain and Anand Prakash, Asst. Advisers, DEPR, went through the drafts of various chapters and offered substantive comments. While Dr Renu Gupta copy edited the volume, Shri P.P. Ramachandran gave valuable suggestions on all the chapters. Ashok Kapoor, R.L. Sahoo and P. Ravikiran Pala of the RBI archives pieced together the documents required for writing the history.

The members of History Cell of the DEPR, namely, SVS Dixit, Jayanthi K. Anand and Gunjeet Kaur, supported by M. Seenuvasan, K.M. Thirunavukkarasu, Rajiv Lochan, R.J. Ubale, Ann Verghese, Anil Chodankar, Girish S. Vagal and Geeta Kamath ensured the progress of the drafting of the volume in a time-bound manner, besides providing unstinted secretarial support to the Advisory Committee.

Shri Deepak Mohanty, Executive Director, was closely involved in drafting the volume and monitored the work of the History Cell at every stage. The project of writing the current volume of Reserve Bank history was carried out under the overall supervision of Dr Subir Gokarn, Deputy Governor, who was also a member of the Advisory Committee.

Finally, let me thank Dr Duvvuri Subbarao, Governor, who asked me to chair the Advisory Committee and Dr Rakesh Mohan, former Deputy Governor, who also served as a member of the Advisory Committee, for their continuous support and advice.

I do hope that this volume will serve as a rich resource for all who are interested in studying the evolution of the Reserve Bank of India and a timely and useful addition to the compendium of the earlier three volumes.

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Bimal Jalan
Chairman
Advisory Committee