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Epilogue

The first sixteen years of the Reserve Bank's functioning, covered in this volume, constitute an eventful period. The Bank was established in 1935 after long years of preparation, by the Reserve Bank of India Act, 1934, with unqualified support within the country and from the British rulers and with remarkable consensus as regards its functions. In two respects, however, nationalist opinion was not happy with the Act, namely, the status of the Bank as a shareholders' institution and the limited scope envisaged for the Bank's role in the sphere of agricultural credit. However, a redeeming feature was that an obligation was laid on the Bank to submit proposals for a more active role in the field of agricultural finance. The Bank was able to start under favourable auspices, drawing upon the experience and personnel of the Government's Currency Department and the Imperial Bank of India.

In considering the progress of the Bank during this period, several factors have to be kept in mind. In the first place, the Bank's functions as laid down in its Statute were, by and large, of the traditional type, namely (i) issue of currency, (ii) acting as bankers' bank and (iii) acting as banker to Government. No great promotional role was envisaged for the Bank, except to a limited extent in the sphere of agricultural credit. Secondly, during the major part of the period covered in the volume, limitations were imposed on the Bank's freedom of operations by the fact of the country's being a dependency. The early years of the period were characterised by lack of harmony among the top executives in the Bank as also between the Governor and the Finance Member, leading to the former's resignation. Furthermore, the major part of the sixteen-year period comprised abnormal years -six war years followed by over three years of political strife culminating in partition of the country and its aftermath. Normalcy could be said to have returned only in 1949.

The fundamental objective of establishing the Reserve Bank was the unification of the authority to discharge the functions mentioned earlier, so that there would be pooling of the country’s monetary reserves and their employment in accordance with the needs of the economy. What was contemplated was a modest and purely temporary credit extension by the Bank to Government as well as commercial and co-operative banks, mainly with a view to narrowing significantly the marked regional and seasonal imbalances between the demand for and supply of currency and credit and the resultant large variations in interest rates; This objective appears to have been achieved broadly in that formal credit to Government was restricted, although the occurrence of World War II and the mode of financing war expenditure on behalf of the Allies led to considerable expansion of currency against foreign exchange resources. Through advances and open market operations, the Bank provided reserves to the banking system as it needed, though the requirements themselves were modest, largely reflecting the low tempo of investment activity in the economy for many years. The progressive liberalisation of the Bank’s remittance facilities also helped considerably the integration of the country’s money market and a reduction of the seasonal and regional variations in money rates.

The framers of the Bank’s Statute also envisaged the development of a commercial bill market to provide elasticity to the currency and credit system. The Bank’s efforts in the direction of developing a bill market comprised (i) getting the Government to agree to reduce the stamp duty on bills of exchange and (ii) urging the Provincial Governments to establish independent licensed warehouses. While the Bank was successful in the former, very little progress was made with regard to the latter. However, as in foreign countries generally, following the growth of branch banking, the functions of a commercial bill as well as its worthwhileness were rendered less significant.

In the sphere of currency management, there was not much scope for the Bank to attempt innovation or improvements in the mechanical field of the issue of currency, for the old Currency Department was fairly well organised. However, apart from increasing the number of currency chests and the places where these chests were kept, the Bank provided a measure of elasticity to the currency system through its loan and open market operations, including purchases and sales of sterling. The Bank also played an important role in the introduction of one rupee notes and in the gradual demonetisation of silver; the introduction of the pure nickel rupee, in particular, owed much to the Bank’s vigorous canvassing. In the brief pre-war period, the obligation to maintain what was considered to be an overvalued exchange rate, namely, 1S. 6d., had acted as a constraint on the Bank’s freedom in the matter of expansion of currency. For the same reason, the Bank was not in a position to reduce the Bank rate for activating the economy in the closing years of the Depression. However, the real problem for the Bank was to ensure that the benefit of the prevalent low rates in the organised money market was extended to the rest of the economy.

As a bunkers' bunk, the Reserve Bank's duty was two-fold. First, it had to act as a source of reserves to the banking system, especially for meeting its seasonal requirements, apart from acting as lender of the last resort in times of emergency. The second responsibility of the Bank, which did not figure prominently in the early stages but which assumed importance after the' failure of the Travancore National and Quilon Bank, was to ensure that banks were established, and run on sound lines, emphasis in those years being mainly on the protection of the depositors' interests rather than on credit regulation. So far as the commercial banks were concerned, the Bank appears to have reasonably fulfilled their needs for short-term financial assistance, though the banking system was unhappy that the scope of the Reserve Bank's accommodation was in effect limited to advances against Government securities. Considering the tempo of the economy and the liquid position of the banking system, this did not seem to impose much of a hardship on the banking system till the 1950s. As regards banking regulation and supervision, although the passage of a comprehensive Banking Companies Act was accomplished only in 1949, the Bank made very sustained efforts in this behalf from 1939 onwards. It was largely on the Bank's initiative that some interim measures of legislation were undertaken to achieve the main purposes of bank regulation. The Bank lost no time in building up adequate machinery for coping with its many responsibilities under the Banking Companies Act; as a matter of fact, some years earlier, in August 1945, it established a full-fledged Department for the purpose. The fact that, notwithstanding the rather haphazard and unhealthy growth of banks in the war and early post-war years, bank failures in the country were comparatively few bears testimony to the success of the Bank's regulatory efforts.

Till about the 1950s, the Bank did not take an active interest in matters like extension of banking facilities and promotion of the banking habit. The Bank's philosophy apparently was that its first responsibility was to help the establishment of a sound banking system, which it was hoped would indirectly assist both the growth of the banking habit and the extension of branches to underbanked and unbanked areas. It should moreover be added that in the war and early post-war years the problem for the authorities was mainly one of curbing the tendency to open branches indiscriminately.

Perhaps the most active part of the Bank's operations during the period covered in the narrative related to the Bank's responsibilities as banker to Government. In this field, while there were no spectacular developments, the Bank took considerable pains to systematise the arrangements with regard to loan floatations of the Central and Provincial Governments and the issue of their Treasury bills. The large-scale borrowing by the Central Government during the war years was to some extent at least the result of the skilful operations of the Bank in this behalf. The Bank endeavoured to make the Treasury bill a money market instrument, but on the whole this did not meet with success. The Bank however succeeded in promoting financial discipline on the part of the Provincial Governments through regulating their borrowings in the form of market loans and Treasury bills or the Bank's ways and means advances to them.

An aspect of the Bank's functioning which came in for considerable criticism was the manner in which rupee resources were made available to the Government of India, against sterling assets, for meeting the expenditure of the U.K. and the Allied Governments in World War II. Many critics complained that the Bank's free supply of rupees to Government in this manner constituted a flagrant violation of the most important consideration mentioned by the Government for the Bank's being constituted as a shareholders' bank. This was that Government should not themselves be the authority controlling the creation of money but that when they wanted money they should go to an independent authority and make out their case just as any private individual had to do. This matter has been dealt with at length in Chapter 10 and all that one need say here is that the circumstances were abnormal and that the Reserve Bank Board showed much greater concern in the matter than is generally recognised. As regards the widely expressed view that the Central Board of Directors should have tendered their resignation rather than acquiesce in the policy of currency expansion against sterling, the question is whether that step would not have deprived the country of the vigilance and restraint which the Board exercised in many directions for safeguarding the national interest. In those years, ' with the resignation of the Congress Ministers in the Provinces and the absence of the Congress Party from the Legislatures, the Central Board of the Reserve Bank remained the only elected or representative custodians and trustees of India's economic and monetary interests '. The Board won a signal victory in having an Indian appointed as Governor and this was helpful to some extent in reorienting the Bank's attitude with regard to inflation and in putting pressure on Government to take action to contain it.

In the sphere of monetary policy there was not much experimentation in the period covered in this volume. In the pre-war years, on account of the stagnant conditions generally, demand for credit was on the whole at low ebb. While there were hardly any problems like restraining inflation or curbing investment, management of the foreign exchange and especially the maintenance of the exchange rate at 1S. 6d. posed some problems. On the whole, the Bank carried out its responsibility with skill, mainly by varying its policy with regard to purchase of sterling by tender and by suitable modifications of the Treasury bill policy. In the war and post-war years there were no problems in regard to exchange management. The problem was one of countering inflation. The Bank's instruments of credit control were mainly two, namely, the Bank rate and open market operations. The Bank rate instrument was not used at all in this period, except once in November 1935 when the rate was reduced from 3 ½ to 3 per cent; the rate remained unchanged thereafter till November 1951. However, it would be incorrect to say that the instrument of interest rate was totally unused, for, the Bank did take a lead in bringing about appropriate changes in the Treasury bill rate, which was of some significance in influencing the flow of funds from abroad. Government bond yields were also suitably varied to meet the needs of the situation, within the general framework of stable rates. In the war and immediate post-war years the Bank resisted Government's wishes for cheaper money and in the subsequent years it worked skilfully to bring about a gentle rise in yields in the interests of credit regulation. The Bank also employed the instrument of open market operations in a fairly substantial way. It built up the necessary network of brokers and operational standards to sub serve the needs of Government borrowing as well as the requirements of the money market. From the very beginning, these operations of the Bank embraced all maturities and not merely short-term bonds as in the case of many other central banks, one important result of which was that the Bank's operations had an impact on the capital market too. In the post-war years, with the increasing needs of banks, the normal distinction between busy and slack seasons tended to be obscured and there was a steadily increasing resort to the Reserve Bank for accommodation, which put the Bank in a position to exercise a fair amount of control over the credit system.

It was perhaps the Bank's role in the sphere of rural credit that formed the main target of criticism during these years. The Government, at the time of the passing of the Reserve Bank Bill, did not envisage an active role for the Bank in the supply of finance for agricultural purposes. Its role was to be largely advisory, viz., to assist the Provincial Governments to reorganise and strengthen the co-operative movement. The Bank was also expected to make concrete proposals for the linking of the indigenous bankers and moneylenders with the organised money market. On the other hand, national opinion in the Legislature and outside and, in particular, of the co-operative institutions was that the Bank must play a very active role in the sphere of agricultural credit, providing not only advice but substantial accommodation out of its own resources to the extent that might be necessary. In the earlier years, the Bank's policies largely followed the Government's conservative approach, as mentioned above. The Bank's view was that co-operative institutions, in order to be credit-worthy and eligible for accommodation from the Bank, must reform themselves and improve their operational standards so as to be on par with commercial banks. The Bank's emphasis on the co-operative institutions being run on sound lines was no doubt well placed and in fact the Bank helped a great deal by suggesting appropriate norms and guidelines for bringing about higher standards of operation and management. But the question was whether, simultaneously with the reform of the co-operative system, a substantial extension of credit by the Reserve Bank to the co-operatives was not called for. Gradually, as a result of continued pressure from co-operative interests as well as the enlightened leadership in the Bank itself under the guidance of its top executives, the Bank's approach became increasingly liberal. Many initiatives were taken to enlarge the flow of the Bank's assistance for agricultural purposes - seasonal operations as well as marketing of crops. The introduction in 1942 of a concessional element in the rate of interest on its loans and discounts to the co-operatives was an important step taken by the Reserve Bank authorities in this behalf. From 1949 onwards, the Government's and the Bank's interests in agricultural credit deepened considerably, leading to the appointment first of the Rural Banking Enquiry Committee in 1949 and the All-India Rural Credit Survey Committee in 1951. These paved the way for a marked expansion of the Reserve Bank's and Government's role in the sphere of agricultural credit and for radical organisational changes in the commercial banking system too, beginning with the transformation of the Imperial Bank of India into a public sector institution.

Another line of criticism against the Bank's working in a related field concerned its failure to bring the indigenous bankers into direct relationship with the Reserve Bank. The matter was unusually complex and the Bank had misgivings from the outset as to whether this was practicable. Nevertheless, it made repeated efforts to get the indigenous bankers to agree to a modicum of discipline, by shedding their non-banking business and maintaining proper books of accounts. But the indigenous bankers were not agreeable to these reforms. Directors like Sir Purshotamdas Thakurdas, who took much interest in the matter, conceded that the Bank had done all that was possible in this regard.

On the other hand, the Bank was actively and fruitfully involved in the building up of an adequate machinery for the provision of finance for industry, leading to the setting up of the Industrial Finance

Corporation of India and the passing of legislation for the setting up of State Financial Corporations.

Again, in the establishment of the International Monetary Fund and the International Bank for Reconstruction and Development, the Bank played an important role. The Bank's executives and the Central Board took considerable initiative in these matters from very early stages. The Bank's efforts facilitated India's getting a better deal than looked likely in the early stages of the formulation of the international currency plans. For the first time India was enabled to become on its own right a partner of the international monetary system; this development has proved to be of great significance to India's economic development. It is true that in the final shape of these plans no provision was made for the liquidation of the sterling balances. Nevertheless, in the matter of rebutting British and foreign opinion for the scaling down of sterling balances and the successful negotiation of a series of agreements, the Bank's contribution was significant.

The Bank's organisation was steadily geared to meeting its increasing responsibilities. The Bank opened from time to time new offices and in particular new departments. In the beginning, the only important Department, and a statutory one, was the Agricultural Credit Department. But by the time this narrative ends, that is, around April 1951, the Bank had several full-fledged Departments besides the A.C.D., namely, the Exchange Control Department, the Department of Research and Statistics, theDepartment of Banking Operations and the Department of Banking Development, the last named also attending to matters relating to industrial finance. The establishment of the Department of Research and Statistics, in August 1945, reflected not only the concern of theBank's management and Board for the discharge of the Bank's traditional functions efficiently, on the basis of comprehensive, accurate and up-to-date material (which was also to be placed at the disposal of the public through the Bank's publications) but also their tremendous foresight in regard to the expansion of the Bank's promotional role in the years to come. This was all the more commendable since at that time even in the developed countries generally the role of research in central banks had not received adequate recognition. The establishment of the Department of Banking Development in October 1950 was yet another landmark in the Bank's organisation, evidencing the Bank's intention to play an active part in developmental matters.

In the sphere of recruitment of staff, policies were gradually evolved with a view to ensuring efficiency, wide geographical and communal representation and reasonable prospects for promotion from within. Training of staff was to receive greater attention at a later period. On the other hand, the entire period was marked by remarkably harmonious employer-employee relations.

It could be said that on the eve of planned development in 1951, the Bank was organisationally well prepared to play its due role in the efforts to promote the country's economic growth. The Bank by then had acquired enough experience and expertise in the performance of the traditional functions of a central bank. It had obtained fairly adequate control over the money market. Its relations with the commercial and co-operative banks had become fairly intimate and cordial. Also, happily even in the formative years the Reserve bank enjoyed unquestioned leadership and confidence in the money market. From almost the very beginning it was regarded as the premier money market institution. The enactment of the Banking Companies Act gave special authority to the Bank to supervise the operations of commercial banks, so as to ensure their establishment and working on sound lines. The Act was responsible for the weeding out of the weaker elements of the banking system, which was now ready to march forward, not only by way of expansion of branches but also in the direction of a widened scope of operations in keeping with the requirements of the economy. Further, by 1951 it had become a well-established practice for commercial and co-operative banks to turn to the Reserve Bank for accommodation. In other words, the Bank was in a position to pursue a credit policy that was both expansionary and regulatory, broadly in keeping with the investment priorities indicated in the Plans. The Bank's involvement in industrial financing extended its influence in the capital market too, thus enabling it to make some impact on the short-term and long-term markets for money, in the larger context of development financing.

The substantial experience which the Bank acquired from 1939 onwards in administering exchange control put the Bank in a position to exercise such control during a period when there was likely to be considerable balance of payments strain in connection with the implementation of the development programme. The membership of the Bretton Woods institutions, the I.M.F. and the I.B.R.D., was an important element in the availability of short-term and long-term foreign exchange credit. The close contact which the Bank had with these institutions also widened its perspective with regard to monetary and developmental finance matters.

In these various ways the Bank was reasonably well equipped to participate in the developmental effort. As compared to its early years, attitudes had clearly undergone a marked change in the direction of involving the Bank in promotional tasks in an active way. The change reflected in part the change in the country's status from a dependency to an independent nation and the growing recognition in the post-war years of the importance of the role of the Government and public sector institutions in economic development. But it was also due to the initial thinking and planning on some of these tasks, as exemplified by the proposals for setting up an industrial finance corporation, under the guidance of the first Indian Governor. After nationalisation, perhaps the Bank's executives were freer to embark on developmental tasks as compared to the pre-Independence and pre-nationalisation days. In earlier years, the Bank's management had to steer a course that did not clash with the Board's attitudes and the foreign Government's philosophy. In 1951, the position was, however, different. For one thing, the Board had nothing to do with the appointment of the Governors; for another, the Board itself was a wholly nominated one. It is difficult to say to what extent this change in the Board's position detracted from an active and independent role for the Board, such as was observed in the pre-nationalisation days. Undoubtedly, in these matters it is also a question of personalities, of the Governor, the Directors and the Finance Minister. All along, of course, the Governor's pre-eminent position for guidance and initiatives was recognised. The relationship of the Governor and Deputy Governors with the Board of Directors on the one hand and with Government on the other is a delicate one, calling for understanding, tact, self-confidence and courage. It has been recognised for long, as the Patman Committee 'of the U.S. Congress put it, that central banks should strive for independence within the Government rather than *from* Government. There is little doubt that in the period covered in this narrative, the Governors set for themselves high standards in the conduct of the Bank's affairs, harmonising the statutory requirements, the wishes of the Board of Directors and policies of the Government.

In the two decades or so from the time this narrative comes to a close, the Bank has made rapid strides in streamlining and expanding the credit system so as to serve the needs of an economy developing in terms of a series of five-year plans. The Bank has also witnessed the strains of development, necessitating the use of general and selective instruments of credit control. Perhaps it would not be out of place to give a bird's eye view as it were of the many developments in the promotional and regulatory spheres.

Commendable progress has been made in a sphere in which the Bank's role had come in for much criticism, namely, rural credit. The Bank initiated prompt action to implement the recommendations of the Rural Banking Enquiry Committee and later of the All-India Rural Credit Survey Committee. The quantum of financial assistance from the Bank to the co-operative institutions recorded a phenomenal rise over the years, from about Rs. 3 ½ crores at the end of March 1951 to about Rs. 300 crores in early February 1970. The forms, of assistance provided by the Bank have also been diversified considerably. Among the noteworthy events in the sphere of institutional arrangement for agricultural development was the establishment, in July 1963, of the Agricultural Refinance Corporation, as a subsidiary of the Bank; the total amount of refinance disbursed by the Corporation up to June 30, 1969, was of the order of Rs. 30 crores. Simultaneously, the Bank has also endeavoured to raise standards of co-operative management, an important step taken in this matter being the extension, in March 1966, of the provisions of the Banking Companies Act to co-operative institutions.

In the sphere of commercial banking, apart from further measures of a regulatory nature, the Bank has accomplished much in the sphere of banking development. The transformation of the Imperial Bank of India into the State Bank of India in July 1955 and that of a number of State-associated banks as subsidiaries of the State Bank of India helped both the opening of banking offices in the rural and semi-urban areas and the provision of credit to priority sectors hitherto neglected, such as small scale industries.

The institution in 1962, of a system of insurance for commercial bank deposits - India being the second country to do so -was yet another promotional measure for which initiative came from the Bank, which supervises the work of the Corporation set up for the purpose.

The Bank's participation in industrial financing has steadily and fruitfully increased, pari passu with the growing importance of industrial investment in the country's development. Besides its close association with the Industrial Finance Corporation of India and the State Financial Corporations, the Bank was closely connected with the establishment (and working) of the Refinance Corporation for Industry, in 1958, for the refinancing of medium-term loans for industry provided by commercial banks and State Financial Corporations. The Bank's involvement in industrial financing occurred in a big way with the establishment, in July 1964, of the Industrial Development Bank of India, as a wholly-owned subsidiary. The bank was conceived not only as a financing institution but also as a developmental agency, in preparation for the country's embarking upon the establishment of sophisticated and capital intensive industries, in the chemical and metallurgical fields in particular. This Bank is beginning to fulfil the role of an apex institution in the sphere of term financing, co-ordinating the operations of other term financing institutions.

Yet another institutional agency, in whose establishment the Bank took initiative, was the Unit Trust of India, to mobilise savings of small investors desirous of investing in corporate securities. The Trust, in which the Bank holds one half of the initial capital of Rs. 5 crores, was established in February 1964, and commenced operations in July that year.

From 1954, beginning with the establishment of the Bankers Training College, the Bank, in co-operation with commercial banks, co-operative institutions and the Central Government, has been giving increasing attention to the training of personnel of commercial and co-operative banks. More recently, training of the Reserve Bank's own personnel has been taken up in some earnest. In the sphere of training, a new dimension was reached in 1969 with the establishment of the National Institute of Bank Management.

The path of development is not smooth and the Bank's role has been not merely promotional but also regulatory. The Bank has used extensively all the well-known instruments of credit regulation, general as well as selective, besides moral suasion. The performance of this difficult task has been facilitated by the wealth of financial data collected by the Bank itself and carefully analysed by its economists and statisticians. In 1956 the Bank was vested with the power to vary, within broad limits, the statutory reserves which commercial banks have to maintain with the Bank. There has been much experimentation with credit regulation instruments and it is beyond the scope of this chapter even to describe them in any detail. Bank rate was raised on several occasions, from November 1951 onwards, the rate reaching a peak of 6 per cent in February 1965; in March 1968 it was lowered to 5 per cent. The Bank has also tried the expedient of a system of penalty rates, originally based on the quantum of borrowing from the Reserve Bank in relation to the statutory reserve requirements, but later on the net liquidity ratio of the borrowing bank.

The Bank has also made some effort at credit planning, guiding the commercial banks with regard to both the aggregate quantum of credit creation, season-wise, and its sector-wise distribution, and employing the device of incentives and penalties in the rate structure. The Bank has also stood ready to provide temporary accommodation to banks for meeting their seasonal requirements of reserves, though the seasonal fluctuations in credit expansion are narrowing. For this purpose, as early as January 1952, the Bank instituted the Bill Market Scheme, enabling banks to borrow from the Reserve Bank against the security of their advances converted into usance bills -an example of the adaptation of the lending practices of banks to suit the provisions of the Bank's Statute. The changes in credit policy have been made generally after discussion with bankers; the contacts between them and the Reserve Bank have become close and cordial, in this process the Bank trying to get the best of moral suasion and statutory control.

No attempt has been made in this volume to assess the success of the Bank's regulatory efforts in the monetary sphere. In the best of circumstances, this is an exceedingly difficult task. The Bank's policies constitute only one element of the control mechanism, fiscal operations and policies exercising a much greater influence. Monetary policy has had to operate in the context of large-scale budgetary deficits, generally speaking from the Second Plan onwards. Judged by criteria such as the rate of growth of real income, price stability and equilibrium of balance of payments, the achievement of policies in the fiscal/monetary spheres could be regarded as only partial and modest. There has been to an extent the need to balance the promotional and regulatory roles, a dilemma not unknown in developing countries.

What seems to be, however, beyond dispute is that the Bank is endeavouring to improve continuously its institutional machinery and operational techniques in the twin areas of development and control. Without doubt the Reserve Bank's hold over the credit system has increased considerably, with growing institutionalisation of credit. In this context, mention may also be made, without implying any judgement, of the restrictions imposed in 1966 on the acceptance of deposits by joint-stock companies.

The past two years have witnessed what might perhaps be termed dramatic developments in the banking world, namely, the experiment, for a short period, of social control and then the nationalisation of 'major' commercial banks. There is no doubt that the banking system is in the process of a far-reaching reorientation. Many new problems will arise in the coming years. Whatever be the emerging pattern of the banking and credit system, the Reserve Bank is reasonably well equipped to carry out the tasks allotted to it. In regard to the important aspects of the personality of the Governor and the spirit of objectivity and independence of outlook of the Board, generally, high traditions were built up during the period of the History covered in this volume, even as strong foundations were laid -perhaps a few floors also built for a large superstructure to grow.