
Subsidiaries of the State Bank

The integration of the banking systems of the princely states merging into the Indian Union acquired importance soon after independence. Several of these states had banks associated with them which discharged important banking and treasury responsibilities on their behalf. One of them, the Hyderabad State Bank was earlier a bank of issue in the Nizam's dominions. Many of the other banks too, were important in their own right or were the most significant local banking institutions in the areas where they operated. Inevitably, given the diversity of circumstance, forms of ownership, and organization, relations and functional arrangements between governments of the princely states and their associated banks varied widely. Some of the former princely states owned banks which they ran as government departments, while others owned a major portion of the share capital in their 'state' banks. In a few cases, state-associated banks were almost entirely privately-owned, in one case—that of the Krishna Ram Baldeo Bank, Gwalior—by the ruler himself. Some states had banking arrangements with commercial banks and conducted treasury work, either wholly or partly, through government departments. Diversity also marked the constitution of these enterprises. Some state banks were constituted by acts passed or promulgated locally while the Bank of Baroda, notably, was incorporated under the Companies Act of the Baroda state. At the other extreme, the Bank of Patiala was set up by a firman of the ruler while the Sri Ramchandra Laxman Bank, Dungarpur, which too did not have a written constitution, was probably set up on the basis of a verbal order of the ruler.

There were, according to the Bank's admittedly incomplete count, fifty-four 'state-owned or controlled' banks (hereafter referred to as state banks or state-associated banks) of various sizes in March 1952. In the changed political conditions, governments of states as they were constituted in independent India came to inherit the interests which the former princely states held in these institutions. State banks varied enormously in size, with the Bank of Baroda which was the largest of them all having, for instance, deposits running into

several crores of rupees. At the other extreme, the aggregate deposits of the Bank of Barwani amounted to a princely sum of Rs 3,000.

After 1950 it became possible to distinguish two categories of state banks. The first category comprised institutions, too numerous to list here, whose governmental responsibilities largely fell into disuse following the amalgamation of the states of which they were bankers with existing or new states of the Union. A relatively large number of the smaller state banks in this category were weak, moribund, or on the verge of liquidation, and securing the orderly winding-up of their affairs or amalgamating them with stronger banks became an important focus of the Bank's efforts in relation to these institutions. Until such time as this segment of banking was reorganized, the Bank had also to regulate its functioning from the point of view of safeguarding the interests of depositors and minimizing the contingent liabilities of state governments which held an interest in these institutions.

The second category comprised the larger state banks. Not only did these banks retain a major presence in their respective states particularly in the non-urban areas, they also continued to discharge some governmental banking functions even under the new political arrangement. Such banks were expectedly fewer—about fourteen—in number. Regulating their functioning was no doubt important, but the Bank's approach to the latter set of institutions was also informed by its efforts to promote sound banking treasury and currency chest arrangements in the regions covered by them.¹ Hence it was thought necessary to align the constitution of these institutions in such a way that while centre-state financial relations and government operations were facilitated, the structure, policies, and operations of the banks would be subject to control by the central government and the Reserve Bank of India. This realignment had to be achieved, moreover, in the context of extending banking facilities, particularly to the rural and semi-urban areas of the country.

REGULATING THE STATE BANKS

The classification of state banks attempted above also helps us track the Bank's objectives and actions in relation to these institutions. As we will observe below, not all banks in the second category were well-run institutions, but the Bank's principal concern in relation to banks in the first category was that of regulating their activities from the point of view of protecting the public interest. The latter partly represented the interests of the depositors. But equally, several banks had managed to gather deposits on the strength of

¹ For a short description of these arrangements, see footnote 2 in chapter 6.

their association with princely states or that of guarantees offered by them. Following the political reorganization of 1947–49, these liabilities passed, willy-nilly, to the respective state governments. Once undertaken, public responsibilities of this nature could not easily be shed without causing dislocation and uncertainty, even perhaps a banking panic. On the other hand, legal opinion at the time held that state governments exceeded their constitutional and legal powers in owning or operating banks. Neither did they possess the 'requisite equipment' to effectively oversee their functioning in the public interest. The Reserve Bank's ability to intervene in the affairs of these institutions too, was weakened by legal obstacles. Given the manner of their incorporation and their constitutions, these banks did not generally come under the scope of the Banking Companies Act which had meanwhile been extended to the new states, nor could they be wound up under the Indian Companies Act. Consequently, many of the state banks were 'free to operate in any manner they choose, and ... to open branches ... without any restriction whatsoever'. Let alone overseeing their working or subjecting them to statutory inspection or regulation, the Bank in 1949 did not even possess a complete list of state-owned and controlled banks.

As a first step towards gaining an understanding of the working of these institutions, the Bank encouraged some of them to volunteer to open their books to its officers for inspection. The Bank's inspections revealed, in several cases, an alarming state of affairs. Many of these banks followed unsound, or at any rate 'unorthodox', banking practices. Long-term advances to industry and public utilities were not uncommon, while few state banks respected the distinction between long-term and short-term lending, or that between agricultural and commercial finance. The staff of these banks were, as a rule, poorly qualified and trained. In the case of one state bank, the Bank's inspectors discovered, several years had elapsed since its accounts were audited.

The Reserve Bank's counsel had already been sought by the Saurashtra government in 1949 for reorganizing banks associated with the princely states of Saurashtra. At the Bank's instance, the Bhavnagar Darbar Bank was constituted as the State Bank of Saurashtra and three other former state banks in the state merged with it. The new bank came into existence early in 1950. At a later stage, steps were taken to merge two more minor state banks with the State Bank of Saurashtra. The Bank's ability to adopt this solution more widely was affected by legal and constitutional uncertainty over whether state governments could own and operate banks, since banking was in the Union list. The Attorney-General whose advice was sought by the Government of India opined that central and state governments were not 'competent' to own or operate industrial or commercial undertakings unrelated to matters within

their legislative competence. This particular obstacle was not overcome until later in the decade.

In the meantime, the Bank sought to achieve a measure of reorganization of state banks, and some control over their working. Following the Bank's recommendation, the assets and liabilities of four small banks in Rajasthan were transferred to the Bank of Rajasthan. In a few other cases, the Bank recommended the merger of state-associated banks with joint-stock banks. Some state banks, such as the Bank of Kurundwad (Junior), the Bank of Sirmur, and the Bank of Bhopal were converted into land mortgage and central or state cooperative banks, and incorporated under the relevant Acts of their respective states. While the Bank remained willing whenever its advice was sought, to explore various possibilities, in general it took the view that some state banks might 'die a natural death'. Some moribund or 'merely ornamental institutions' might have to be wound up, while others would be absorbed by one or the other of the existing joint-stock banks. Very few state-associated banks, the Bank felt, could afford to retain an independent existence.

Whatever the longer-term solution, however, the Bank recognized that the former state banks represented an 'important link in the chain of Indian banking' which could not afford to 'remain unregulated for long' The Law Ministry in the Government of India suggested a 'simple enactment' to authorize the Bank to examine the constitution and financial position of each state bank in order to determine its future. An amendment to the Banking Companies Act to bring these banking institutions specifically under its purview, as was done earlier in the case of the Imperial Bank, was also briefly considered. But legislative measures were rejected on the ground that they would consume too much time. Besides, an amendment to the Banking Companies Act might turn out to be unnecessary in the event of a majority of these institutions failing to survive the changed political circumstances in their present form. Hence the Bank pursued a two-pronged policy, one prong of which was to persuade state-associated banks to voluntarily bring themselves under the purview of the Banking Companies Act. This strategy was quite successful and by the end of March 1952, twenty-nine of the fifty-four state-associated banks had come within the scope of this Act. Six of the remaining banks had either ceased to exist or were in the process of being wound up, while the ownership of three small state-associated banks was in dispute. However, the remaining sixteen banks, which included some of the larger state-associated banks such as the Bank of Patiala, the Hyderabad State Bank, the State Bank of Saurashtra, the Mayurbhanj State Bank, and the Bank of Baghelkhand, could not be

brought under the Banking Companies Act without amendments to their constitutions.

The second prong of the Bank's strategy of dealing with state-associated banks was therefore directed mainly at these sixteen institutions. The Bank sought a temporary solution in their case whereby these banks volunteered to conform to the operational provisions of the Banking Companies Act and subject themselves to the essential disciplines and requirements of the legislation without, at least yet, coming under its formal purview. It advised the central government to take up with state governments the question of state banks under their administrative jurisdiction submitting to regular inspection by the Bank's officers, furnishing periodical returns as required under the Banking Companies Act, and supplying to the Bank any further information it required. Apart from enabling it to secure a proper understanding of their position and functioning and recommend corrective measures, regular inspections and returns were also expected to help the Bank formulate ways in which individual state banks may be 'integrated with the Indian banking system'. Under the informal and transitory regulatory regime which the Bank envisaged for them, state banks were also to desist from extending their operations beyond the borders of the state or union of states in which they were located.

State governments were not always ready to accept these conditions. The Punjab government, for example, looked the other way when the Bank of Patiala opened branches outside the former PEPSU region in 1957. Nor were the Bank's efforts to ensure that state banks submitted periodical returns to it entirely successful to begin with. Twelve of the sixteen banks whose constitutions required to be amended before they could be brought under the Banking Companies Act did not readily submit to the regime of voluntary returns proposed by the Bank. While the state governments concerned had already initiated measures to reconstitute, liquidate, or amalgamate eight of these twelve banks, the Bank had to make additional efforts to persuade the remaining four banks to submit voluntary returns to it. Notwithstanding such hurdles, by 1954 a problem which had seemed large and rather intractable barely two years earlier was well on its way to acquiring more manageable dimensions.

REALIGNING MAJOR STATE-ASSOCIATED BANKS

The Indian States Finances Enquiry Committee (V.T. Krishnamachari Committee, 1949) which went into the question of federal financial integration remarked on the unsatisfactory nature of banking and treasury arrangements

in the former Part B states and underlined the need to study them separately with a view to bringing these arrangements in line with those prevailing in the 'provinces' of the Union. A review of the treasury arrangements in force in the Part B states was accordingly made part of the terms of reference of the Rural Banking Enquiry Committee (Purshotamdas Thakurdas Committee, 1950). In particular, the committee was asked to examine the extent to which the management of cash work in government treasuries and subtreasuries could be entrusted to one or more of the existing commercial banks, and to make recommendations in regard to the banks which were already handling treasury work in the Part B states.

The Rural Banking Enquiry Committee found that while the Imperial Bank of India carried out some treasury and banking functions for governments of the Part B states, the latter had entrusted a major part of these functions to one or more local banking institutions. Among these were the newly-formed State Bank of Saurashtra, and to some extent, the Central Bank of India in Saurashtra, and the Bank of Mysore in Mysore State. In Rajasthan, the Imperial Bank of India, the State Bank of Bikaner, the Bank of Jaipur, and the Bank of Rajasthan shared the banking and treasury business of the state government. In Hyderabad, the Hyderabad State Bank was entrusted with treasury and banking work, as also that related to the management of public debt and currency, while the Imperial Bank of India too fulfilled a limited set of treasury functions. In Travancore-Cochin, the Imperial Bank of India did the central government's treasury work at Trivandrum, while the state government's cash work was undertaken by the Central Bank of India at Ernakulam. The remaining treasury work was done departmentally by the state government which also had remittance arrangements with some banks. In PEPSU, while the Bank of Patiala and the Imperial Bank of India managed the banking work, the state government also maintained accounts with other banks both in the state and outside. In Madhya Bharat, on the other hand, the bulk of the government work was undertaken by the Bank of Indore, with the Imperial Bank of India playing little or no role in the arrangements.

The committee endorsed the view that banking and treasury arrangements in the Part B states should be brought in line with those in the Part A states. This raised two main issues: (a) the appointment of the Reserve Bank of India as sole banker to the Part B states, and (b) the appointment of agents of the Reserve Bank for managing the government's cash business in those areas. The committee felt that the Bank's appointment as banker to all the states of the Indian Union was basic to the whole scheme of federal financial integration, and should precede any attempt at uniformity in banking and treasury arrangements across the length and breadth of the country. As regards

the second issue, the committee came to the conclusion that with the exception of the Hyderabad State Bank, no other state bank had the resources, standing, or organization to be considered for appointment as the Bank's agent. However, the committee was averse to existing arrangements being disturbed greatly for a period of five years. The Imperial Bank of India, it felt, was unlikely to devote its limited energies to expanding significantly into the Part B states. Besides, sudden withdrawal of state support might inflict serious damage upon the banks associated with them, result in the curtailment of banking facilities to the state government and the public, and cause financial loss to governments which had a substantial interest in them. The standstill period of five years from April 1950, the committee suggested, should be utilized to gain a proper appreciation of the financial and other aspects of the working of each bank and determine its suitability for agency work.

Taking into account the views of the state governments, the Bank and the Government of India came to the conclusion that little would be gained by dogmatically setting aside the claims of banks which had developed in close association with state governments. Moreover, appointing a state bank already doing treasury work as the Bank's agent was judged to be preferable to the alternative of such work being undertaken departmentally. On the other hand, it was not considered practicable to appoint, as some state governments proposed, more than one state bank as agents of the Reserve Bank in any one state. Consequently, it was decided to adopt a differentiated approach to the delegation of agency functions in the Part B states. The State Bank of Saurashtra and the Hyderabad State Bank were to be offered agencies by the Bank in Saurashtra and Hyderabad, respectively. In Rajasthan the role was to be offered to a bank formed by the amalgamation of the Banks of Rajasthan, Jaipur, and Bikaner, provided this was effected within a year, during which interval the status quo would be maintained in regard to treasury and banking arrangements. In Travancore-Cochin and PEPSU, decision regarding the appointment of the Travancore Bank and the Bank of Patiala respectively as agents of the Bank was to be deferred for three years. The Bank of Mysore was to be entrusted agency work in that state after a suitable interval at the Bank's discretion. However, none of the existing banks in Madhya Bharat, including the Bank of Indore, were considered large enough to shoulder agency responsibilities.

Placing the recommendations of the Rural Banking Enquiry Committee before the Central Board in December 1951, the Governor, B. Rama Rau, expressed his intention to conclude and bring into force by April 1952, agreements with state governments appointing the Bank as their sole banker as well as, wherever practicable, consequent subsidiary agreements for

appointing state banks as its agents. He also outlined the rules state governments would bind themselves to observe in respect of minimum balance and ways and means advances, the conditions a state bank had to accept before it could be appointed an agent of the Bank, and the steps that were proposed to be taken to ensure that there was minimal dislocation in existing arrangements. Once the Bank assumed the role of banker to a state government, the latter was expected to transfer its balances entirely to the Bank. But it was proposed to achieve this gradually, and in such a manner as to prevent any sudden erosion of the deposits of banks holding such balances.

The Governor also underlined to the Central Board that the appointment of banks as agents of the Reserve Bank of India necessitated a greater measure of control over their working. Apart from submitting themselves to inspection by the Bank, they were expected to observe certain restrictions on the types of business they could undertake, appoint chief executives only with the approval of the central government, and accept on their Boards a nominee of the Bank and another of the central government. The latter official was to have powers to demand postponement of decisions affecting the government's financial policies or the safety of its monies. Further, it was proposed not to entrust currency chests to these banks unless (a) they were located at a few agreed places of importance in the beginning, (b) the concerned banks accepted restrictions on the use of chests for the banks' own working, and (c) state governments guaranteed the safety of the money held in them.

The Bank commenced its role as banker to governments of Part B states in July 1952. The takeover was completed in November 1956. The process might have lasted even longer had some Part B states not been extinguished in 1956. In the first stage, the Bank became banker to the governments of Madhya Bharat and Travancore-Cochin in July 1952. Agreements with Hyderabad and Mysore followed soon thereafter. The Hyderabad State Bank and the Bank of Mysore were appointed agents of the Bank in Hyderabad and Mysore in March and November 1953 respectively.

In contrast to these four states, the Bank's path in Saurashtra, PEPSU, and Rajasthan was far from smooth. As noted above, the State Bank of Saurashtra, which conducted banking business on behalf of this state government at a majority of the important centres, was constituted by the amalgamation of a number of small units discharging similar responsibilities in the component states. The ordinance which the state government promulgated to bring the new bank into existence was, however, incomplete in some important respects. For example, it did not even specify the businesses which the bank might or might not transact. Nor was the bank a joint-stock institution incorporated under the Banking Companies Act, 1949. Pending the reconstitution of the

State Bank of Saurashtra along suitable lines, the Reserve Bank was appointed sole banker to the state in 1954.

In PEPSU, differences surfaced between the Bank and the state government over the role of the Bank of Patiala. The latter had led a chequered career since it was founded in 1917 on the basis of a firman of the Maharajah of Patiala. A department of the government in all but in name, the Bank of Patiala did not have an independent constitution. Though it held some balances of the state government, it did not discharge any treasury functions on the latter's behalf. The PEPSU government insisted on the Bank of Patiala being appointed as the Bank's agent, while the Bank was willing to consider the suggestion only after observing the bank's affairs closely for some considerable length of time. As already noted, once the Bank took over as banker to the state government, the latter would be bound by stipulations regarding the deployment of its funds, ways and means advances, and minimum balances. The state government was unwilling to accede to these conditions and sought special powers to keep its monies with the Bank of Patiala without any restrictions. With neither side relenting, the issue of appointing the Bank as banker to the PEPSU government remained unresolved until 1956 when, following the reorganization of states, PEPSU was merged with Punjab to whose government the Bank was already the banker.

In the case of Rajasthan, the Rural Banking Enquiry Committee had recommended that the state government should take over treasury arrangements and manage them departmentally at centres where the Imperial Bank of India was not entrusted with these responsibilities. In agreements reached between the Bank and the state government, existing treasury arrangements with the Bank of Rajasthan were allowed to continue for one more year. Thereafter, as pointed out above, the institution emerging out of the merger of the Banks of Rajasthan, Jaipur, and Bikaner was proposed to be appointed as the Bank's agent should it by then be in place. On the other hand, the state government was expected to organize its own treasuries with currency chests if efforts to merge the three banks failed to bear fruit within one year. In the latter event, the state government's treasuries were to be supplemented by the Imperial Bank of India which would be appointed as the Bank's agent. Several efforts were made to secure the merger of these three banks. Initially, the Bank of Bikaner was cold to the idea, and when that bank came round later, the Bank of Rajasthan changed its mind and desired to be left alone. With neither the Bank's intervention nor that of the state government making any impact on the Bank of Rajasthan, it was decided in 1954 to merge the Banks of Bikaner and Jaipur and thereafter renew efforts to rope in the reluctant institution. The proposal to merge the two banks also secured the Bank's consent, but

languished for several more years after the situation changed with the publication of the Report of the All-India Rural Credit Survey and, thereafter, that of the States Reorganization Commission.

RURAL CREDIT SURVEY AND ITS AFTERMATH

The Rural Credit Survey, it will be recalled, recommended the amalgamation by statute of ten major state banks and four minor state banks with the proposed State Bank of India. The major state banks recommended for amalgamation were the State Bank of Saurashtra, the Bank of Patiala, the Bank of Bikaner, the Bank of Jaipur, the Bank of Rajasthan, the Bank of Indore, the Bank of Baroda, the Bank of Mysore, the Hyderabad State Bank, and the Travancore Bank. While identifying the Sangli Bank, the Manipur State Bank, the Bank of Baghelkhand, and the Mayurbhanj State Bank as the four minor state banks which could be brought into the fold of the State Bank of India, the Report of the Rural Credit Survey also advised the Bank and the government to explore the possibility of merging some of the remaining minor state banks with the State Bank of India.

In his letter to the Finance Minister, C. D. Deshmukh, in December 1954 about the State Bank of India plan, Rama Rau expressed himself in 'substantial agreement' with the Report of the Rural Credit Survey. However he pointed out that while the creation of 'an integrated State-controlled banking structure for the whole country covering the Part A, Part B, and Part C States ... should be the eventual aim of policy', the details of the reform, the manner of its implementation, and its timing required more careful consideration. The Government of India also took the view that the takeover of the Imperial Bank of India was the 'first step' towards setting up the 'integrated commercial banking institution' and that the other 'details of ... the manner and phasing of so important a measure of reform' deserved to be examined with 'great care and deliberation'. In the event, this reform took over five years to materialize, and was buffeted in the meantime by disagreements between the Bank and the Government of India, political, constitutional and legal changes, and consequently by some indecision and uncertainty.

Even within the Bank, opinion on the second stage of the State Bank plan was far from united. The Department of Banking Operations fired the first salvo in the debate which was soon to rage within the Bank with a note which represented that the Government of India had 'accepted the principle' merely of nationalizing the Imperial Bank and that the next question to be considered was 'whether and how far and in what manner' the government should accept the committee's recommendation concerning the major state

banks. The note then proceeded to advance several reasons why these banks should not be amalgamated or transformed in the near future into subsidiaries of the State Bank of India. In the first place much of the energies of the Reserve Bank and the State Bank would be devoted in the latter's early years to placing the new institution on a sound footing. Besides, as the pay structure in the banking industry was linked to the size of the employing bank, the amalgamation scheme could lead to higher establishment costs and to the State Bank of India having to curtail plans to extend its activities. The Department of Banking Operations then went on to argue that the nationalization of banking was a relatively 'new experiment' in democratic India. The functioning of banks owned by the princely states had been far from satisfactory. Many of them had granted advances on 'other than purely commercial banking' considerations while not all the banks selected for amalgamation by the Rural Credit Survey were financially sound.

Apart from financial conditions, accounting and supervisory practices and standards of efficiency also varied considerably among and between the major state banks and the Imperial Bank. The rate which the Imperial Bank offered on its deposits was lower than that offered by the state banks, and amalgamation, the Department of Banking Operations argued, might lead to the withdrawal of the bulk of their deposits. Besides, most of the advances which the major state banks had made at higher rates of interest would be unsuitable for the State Bank of India's portfolio. The ten major state banks had 273 offices of which 178 offices were in centres with populations below 30,000. The fall in deposits, advances, and earnings might make it uneconomic for the State Bank of India to operate offices at these smaller centres and lead, contrary to the expectations nurtured by the Rural Credit Survey, to their closure. The amalgamation scheme would, if implemented, also lead to a concentration of the offices of the State Bank of India in the Part B states and in the western parts of the country, leaving the eastern regions including large tracts of Madhya Pradesh, Bihar, Orissa, West Bengal, and Assam with relatively few offices of the bank. The Rural Credit Survey's objectives of securing the expansion of banking facilities in rural areas and improved remittance facilities, the note observed, would 'obviously be better achieved' by the State Bank of India opening offices in the eastern states than by taking over the ten state-associated banks.

Proposing that the move for 'further nationalization' of banking in India should be deferred for some years, the note recommended keeping a close watch in the meantime, on the functioning of the reformed Imperial Bank. It warned:

Nationalized commercial banks were no doubt functioning in other countries, but India is still a very young democratic country and how far Parliament or the Government of the day will interfere with the soundness and working of the State bank ... will have to be watched.

In the meantime amalgamations should proceed if at all on a voluntary basis. While including a provision for voluntary mergers in the State Bank of India Act, the note recommended that the government should also announce its intention not to take over any state-associated bank for the next five years. The powers given to the Bank under the Banking Companies Act would suffice, in the meantime, to serve the object which the Rural Credit Survey had in view.

This line of attack drew a spirited response from the Department of Banking Development with whose assistance Venkatappiah drew up the State Bank plan. Outlining the background to the Rural Credit Survey's recommendations, the Department of Banking Development pointed out that the establishment of currency chests and the conversion of non-banking treasuries into banking treasuries in the Part B states would be hampered if their state banks continued as separate, ill-equipped, and poorly run units answerable only to their respective boards. Nor would it be possible to align the policies of these institutions with national objectives. Nationalization, the Department of Banking Development pointed out, would not necessarily lead to higher operating costs, since state banks would continue to be treated as separate units for purposes of labour awards if they were run as subsidiaries of the State Bank of India. Although many of the state banks were financially weak, none was insolvent. In fact the case for amalgamation rested on the weaknesses of individual state banks and the ability of a strong, well-integrated bank to remedy them. Amalgamation, which was 'merely the principle of achieving strength through unity', this department's note declared, was the only means by which the Bank could get a 'stable and reliable agent in Part B states'.

As for differences in the interest rates offered by the Imperial Bank and the state banks, the Department of Banking Development pointed out that it was a truism that the bigger and stronger the bank, the lower its deposit rates. Even the Imperial Bank did not offer uniform rates across the country, and should it face an erosion of deposits, the State Bank of India too could offer higher rates at some centres. In any event, the question of harmonizing interest rates would not arise so long as the major state banks were run as subsidiaries of the State Bank of India. Amalgamation (or takeover of the state banks), it

argued, would facilitate the expansion of banking facilities rather than hinder it. Not only would nationalization encourage the Imperial Bank and the state banks to look beyond short-term profitability considerations in expanding their presence in under-banked areas, the resulting rationalization would release trained staff and other resources for opening new branches. According to Banking Development, the

case for integration of banks is the same as that on which political and financial integration of Part B states was based. The aim is to unify the banks and thus create the framework we want.

The Bank's Central Board met towards the end of February 1955 to discuss the subject. Rama Rau's own preference, expressed in his memorandum to the Central Board, was for a temporizing approach. Converting the Imperial Bank into the State Bank of India, he believed, was the first step. It would be a 'distinct advantage' to the new institution if 'for an initial and reasonably long period' it was not 'burdened' with the responsibility for integrating the state banks. Thereafter, 'such of the State-associated banks as we may select' could 'in stages' be brought under the 'direct control (and where necessary, ownership) of the Reserve Bank'. In the meantime, the Bank should secure a gradual extension and expansion of the powers of control it already exercised over the Hyderabad State Bank, the Bank of Mysore, and pending its reorganization, the Bank of Patiala.

More or less analogous control, including the power to approve the appointment of the Managing Director or General Manager, could, as the first step, be assumed by the Reserve Bank in respect of each of these banks; and subsequently, at an appropriate stage, each bank *as a unit* could be taken over by the Reserve Bank in much the same way as the ownership and control of the Imperial Bank is proposed to be vested in the State. The integration of these individual banks with the State Bank of India will then be a matter for consideration after sufficient experience has been gained. [Emphasis in the original.]

The advantage of this course of action, Rama Rau emphasized, was that it would guard against any abrupt increase in establishment costs and allow a lengthy interval during which to assimilate the policies of the smaller banks to those of the Imperial Bank of India. Whatever their other consequences, Rama Rau's views persuaded those in favour of the integration project to lower their sights and consider the possibility of the State Bank of India managing the state-associated banks as its subsidiaries.

Rama Rau's suggestions were intended to be tentative and merely offer a basis for discussion. Rather unusually too, his memorandum to the Central Board on the subject was not accompanied by a draft resolution. In the event, the Central Board accorded a cool reception to the Rural Credit Survey's integration proposal. An account of its deliberations on this issue is available in the form of a note which H.M. Patel, Principal Secretary in the Finance Ministry and member of the Central Board, prepared for the Finance Minister. Non-official members of the Board, with the exception of D.R. Gadgil and Dhirendra Nath Mitra, appear either to have generally opposed the integration plan or taken the view that most state banks should be left out of it. Gadgil's reminder that the Government of India had already accepted the plan in principle and that the Central Board was merely required to advise the government on the means of giving it effect, cut little ice with the other non-official members. The Board consequently resolved to advise the government that it would be 'undesirable to provide for the compulsory acquisition of the ten State-associated banks [in the proposed State Bank of India Bill]' Should further experience reveal the 'utility and practicability' of integrating any bank, such integration was 'best effected on the basis of voluntary negotiation'. 'In general', the resolution declared, amalgamation may be 'necessary and expedient in a few instances only ... mainly for constitutional reasons'. Constitutional considerations might dictate the takeover of the State Bank of Saurashtra and the Bank of Patiala, which were wholly owned by the respective state governments 'and possibly, the Hyderabad State Bank of which the major portion of the share capital vests in the State Government'.

Following the meeting of the Central Board, Rama Rau advised Patel that the government should proceed on the assumption that the State Bank of India bill would be confined to the Imperial Bank of India. While restating his view that integration should be brought about in stages, the Governor felt another piece of legislation could be introduced later to take over some state banks. In the meantime, the state governments concerned could be consulted on the subject.

Finance Ministry officials were dismayed by this turn of events. They accepted the Governor's plea to defer the legislation on the future of the state banks and consult state governments, but maintained that the latter's reaction would not be the 'main factor' determining the course of banking integration. Banking was a Union responsibility, and 'while informal consultations need not be ruled out, the decision would have to be related to the policies formulated' by the central government. Patel's note for

the Finance Minister pointed out that, thanks to the Central Board's posture, the initiative on the matter had passed to the Government of India.

The Board of the Reserve Bank having reached the conclusions it did, it is clear that ... the whole matter ... stand(s) remitted to Government and that it will now be for Government to take decisions on all the broad issues arising from the policy already announced. It is unfortunate that these decisions have to be taken without the type of assistance, by way of formulation of criteria, modes of implementation etc., which, it was hoped, could be obtained from the ... Board of the Reserve Bank. I think the primary initiative and responsibility in respect of the consultations with State Governments should now be assumed by the Finance Ministry.

Not having yet ruled out including in the State Bank bill which was soon to come up before Parliament, provisions to amalgamate or take over the ten state banks, the Government of India proceeded with some urgency to initiate discussions with state governments. But the Finance Ministry's attitude towards these consultations came as a disappointment to the Bank. Communicating to Rama Rau the government's plan of action and asking him to spare some officers of the Bank for talks with the states, Patel observed that the letter to the state governments would be so 'worded as to avoid giving the impression that the principle of integration ... [was] open to argument'. This drew a sharp response from Rama Rau who remarked to Patel that it was 'equally necessary to avoid giving the impression ... either in your communication ... or in the subsequent discussions' that the government was 'finally and irrevocably committed' to the 'principle of integration'. He also pointed out that the government was merely committed to establishing a 'countrywide State-controlled banking structure ... with the Imperial Bank as the nucleus', and not as such to the 'integration' of state banks with the latter institution. There were different ways of establishing this countrywide banking structure, the Governor pointed out. The Central Board of the Bank had already rejected one of these, viz. 'compulsory acquisition' of the state banks. If talks were to be of 'real use', they should cover other alternatives such as expanding the State Bank of India to the states, the possibility of 'voluntary amalgamation', and in the latter event, the question of whether the bank concerned would be a subsidiary of the State Bank or of the Reserve Bank.

The practical implications of all the alternatives will have to be ascertained from the point of view of the State Governments and incidentally, of the banks themselves, with a view to deciding final policy ... [and this] object cannot be achieved if the discussions take place on the basis that 'integration', in the sense of compulsory acquisition, is a settled principle on which no views are to be expressed by the State Governments.

The Bank's officers were, as noted above, associated with officials of the Finance Ministry in their talks with state governments. According to an interim report of these consultations prepared at the end of March 1955 by S.G. Barve, state governments did not object to the principle of integrating their state-associated banks with the proposed State Bank of India. They had, in fact, received the recommendations of the Rural Credit Survey, including that for an integrated State Bank, 'with general agreement ... even enthusiasm'. While expressing a 'lively hope' that the new institution, and the proposed reform of rural credit generally, would improve the availability of finance for agriculture and for small and cottage industries, ministers and officials of state governments also recognized that the State Bank's expansion into their regions or states 'could not but affect very adversely the position of the State-associated banks'.

The chief executives of the major state banks, who were consulted informally, were divided over the integration plan. There were objections from some to the principle, deriving either from ideological positions or from the prospect of being deprived of positions of 'patronage and importance', while others endorsed the idea. Nor was there any 'opposition on the political plane' to the idea of integration; on the contrary there was a 'modest enthusiasm' for it. However, there was some anxiety over the methods that would be used to estimate compensation, the future of the staff of these banks, transitional dislocations, the new institution's readiness to sustain the services provided by the local bank, and its responsiveness to local needs.

Pointing out that the concerns voiced by non-official members of the Reserve Bank's Central Board did not find any echo in the states (there was not, for example, 'such a screech on the ground of local sentiment' even among directors of state-associated banks), Barve also took the opportunity to reject the Central Board's argument that the integration plan should be deferred because of the scale of the administrative effort involved. The programme of cooperative organization proposed by the Rural Credit Survey required even greater effort, and having decided on these measures in principle, the government should not be found wanting in implementing them.

Barve was also convinced that the Central Board's opposition to the integration plan stemmed from its 'ideological preference for the private sector in banking'. Having, in the course of his report, disposed of the Bank's reservations about the integration plan, Barve proceeded to examine the reconstitution of the state banks. In his view, there was no advantage to the banks being converted into subsidiaries of the Reserve Bank rather than of the State Bank, since in the latter case it would be possible to bring about the 'ultimate integration' of these subsidiaries with the parent institution. He did not think wage costs would be very different under the two arrangements. In any case, he argued, 'it would be unusual and probably embarrassing' for the Reserve Bank to have fully-owned commercial banking subsidiaries. Finally, Barve proposed that the government should announce in unambiguous terms its decision to 'compulsorily' acquire and integrate the state banks during the debate on the State Bank of India bill, and bring forward the legislation necessary for the purpose.

Barve's report amplified the distance between the Bank's and the government's approaches towards the state banks. The Department of Banking Operations minuted in response to Barve's interim report that the government appeared to have decided, in principle, to proceed with the integration of the state banks without effectively addressing the many doubts and reservations raised about the proposal. It pointed out that state banks had not worked at all well in India due to governments interfering with their operations on 'grounds other than financial'. The central government had made public its intention not to interfere with the working of the State Bank, but it remained to be seen how far this pledge was upheld in practice. In any event, the Department of Banking Operations observed wryly, the government's summary rejection of the recommendations of the Central Board of the Reserve Bank was 'not a good omen in this direction'.

Rama Rau also reacted to Barve's recommendations by noting that nationalization was not the only means of exerting public control and supervision over the state banks. Objecting to the reference to the Bank being motivated by its ideological preference for the private sector, the Governor wrote to Barve to demand that the accusation should be deleted from any notes put up to the Cabinet. Opposing Barve's suggestion that the Finance Minister should announce the government's decision to take over the state banks in the course of the debate over the State Bank of India bill, he repeated the Bank's view that it was necessary to carry out a detailed investigation of each of the state banks in order to determine which of them could be 'integrated' and how. 'I will of course discuss this, and the other issues, with the Finance Minister', Rama Rau added.

No record exists at the Bank of what transpired in these discussions, but clearly, the Bank managed to restrain the government's enthusiasm for an immediate takeover of the state-associated banks. By April 1955 the government grew resigned to the inevitable, and decided to limit the State Bank of India bill to the Imperial Bank of India. As debate raged over the manner in which public control and supervision could be brought to bear on the state-associated banks, it grew clear that the Rural Credit Survey's proposal to integrate them with the proposed State Bank of India had few supporters. Even Venkatappiah appears to have resiled from his original integration plan, preferring instead an arrangement which would preserve the identities of the state-associated banks. The residual argument in favour of the original integration plan was the practical one of using it as a means of securing public control over the Imperial Bank of India. With the Bank and the government deciding to buy out the Imperial Bank's shareholders, even this argument for integration disappeared. The most that almost anyone was willing to contemplate was the State Bank managing state-associated banks as its subsidiaries. Consequently, the bill to set up the State Bank of India included an enabling provision authorizing the new institution to own and manage other banking institutions as subsidiaries.

STATE-ASSOCIATED BANKS IN REORGANIZED STATES

The State Bank of India came into existence on 1 July 1955, and within days of this event the Finance Ministry returned to the charge, with H.M. Patel once again writing to Rama Rau urging an early decision on the state-associated banks' future, since they could not be left 'in suspense for long'. Seeking the Governor's recommendations on the basis of the Bank's inspection of the state banks, Patel informed Rama Rau that his Ministry had already taken preliminary steps to sponsor a bill on state banks in the monsoon session of Parliament. But the Bank's inspection reports were still being compiled. Moreover in the Governor's opinion, the next moves on state-associated banks would have to await reconsideration by the Central Board of its original resolution on the subject, and consultations with the Board of the State Bank of India. But clearly, as a minute by the Chief Officer of the Department of Banking Operations observed, Rama Rau did not share the government's urgency in regard to the state-associated banks. He also seems to have grown doubtful of the merits of integration even in extending banking facilities in the country, and apprehended that it

might, in fact, result in restricting [credit] facilities as neither the State Bank nor a subsidiary of the State Bank working on the basis of rigid statutory regulations would be prepared to provide the type of finance which the various State-associated banks are providing at present.

Even as the Bank deliberated the future of the state-associated banking sector, the Report of the States Reorganization Commission was published. As Rama Rau anticipated, the dust raised by the Report had to settle before any further progress could be made in dealing with state-associated banks. At the same time, the imminent reorganization of states helped frame the considerations underlying the next stage of the integration exercise in a new light. The Commission's Report held several implications for the future role of state banks. Of direct concern to the integration project were the Commission's proposals to abolish the distinction between Part A and Part B states, merge PEPSU with Punjab and Saurashtra with Bombay, and incorporate princely Mysore and Madhya Bharat into the new states of Karnataka and Madhya Pradesh respectively. The disappearance of Part B states also promised to help complete the process of appointing the Reserve Bank as banker to state governments.

The most serious repercussions of the Commission's proposals for the functioning of state-associated banks arose in regard to Hyderabad. Large parts of the state were to be included in Karnataka and Bombay, and this was expected to create serious operational difficulties for the Hyderabad State Bank. Besides the possibility of the assets and liabilities of the bank (in which Hyderabad state held 51 per cent of the share capital) having to be shared with the other two states, there was uncertainty regarding which state government would have eventual responsibility for the bank, particularly in the event of the residuary state of Hyderabad opting, after the proposed interval of five years, to merge with Andhra Pradesh. None of the states in which the bank's branches fell would have any interest in its working and future. As the Reserve Bank noted, the Hyderabad State Bank already followed unsound practices and there was the risk that these might get worse following the dismemberment of Hyderabad state. The latter also threatened the Reserve Bank's treasury and currency chest arrangements in the area. Fourteen of the thirty-three centres in which the Hyderabad State Bank handled government business fell outside the proposed residuary Hyderabad state. The Bank had reservations about having more than one agency bank in any state. If it allowed these branches to handle government business as before, there would be the further anomaly of a bank whose control vested in one state government

conducting business on behalf of another. The future liability at these fourteen centres for the guarantee given by the Hyderabad state for the security of currency chests in the possession of the Hyderabad State Bank was also unclear, since the governments of Bombay and Karnataka could not be expected to uphold guarantees given by another state, particularly in respect of chests located in a bank over which they had no administrative control. As an internal note of the Department of Banking Development pointed out, the Commission's proposals for Hyderabad state would 'seriously dislocate the existing basis and set-up' of its state bank. Hence urgent steps were necessary to 'ensure that our interests and those of Hyderabad State Bank's depositors do not suffer as a result of the proposed reorganization of the State'.

The reorganization proposals created complications for the other state-associated banks as well. Constitutional doubts raised earlier about the powers of state governments to own and operate banking companies would be reinforced in the case of the State Bank of Saurashtra and the Bank of Patiala, since the circumstances in which these banks were founded and run by their respective state governments would have disappeared once the states of Saurashtra and PEPSU lost their identity. The future of the agency role of the Bank of Mysore too would come under a cloud since the Imperial Bank of India already functioned as the Bank's agent in the other regions of the proposed new state of Karnataka. Likewise the future roles of the State Bank of Saurashtra and the Travancore Bank in their new states. Besides, taken individually, many state-associated banks were not strong enough to be entrusted with a large number of currency chests. The reorganization of states might weaken them further if it led to the withdrawal of government deposits. More broadly, officials in the Bank's Department of Banking Development felt, unless local state-associated banks were reorganized and placed on a sounder footing, the justification for appointing them in agency roles in states might weaken as the states which had helped set them up themselves disappeared. That would leave the State Bank of India as the 'only suitable institution for carrying on our agency functions in the territories now comprising Part B states'. But that, as Venkatappiah pointed out in a 24-page note, would be an 'extremely slow and expensive' process. On purely practical grounds therefore, state-associated banks in Part B states remained the most 'obvious choice' as the Bank's agents and as custodians of currency chests. Urging a 'pragmatic rather than an ideological approach' to the problem, Venkatappiah's note underlined that the importance of safeguarding and expanding existing agency, currency chest, and treasury arrangements in the emerging circumstances indicated the urgent need for establishing 'some organic relationship' between state-associated banks and the 'Reserve Bank and/or the State Bank'.

From the very outset, i.e. since the discussions preceding the Central Board meeting in February 1955, it had been decided to leave the Bank of Baroda out of the list of state-associated banks recommended for takeover by the Rural Credit Survey. Although it had a history of state-association, the Bank of Baroda withdrew from undertaking treasury functions on behalf of the government after the expiry of its agreement with the Baroda state government in 1953. Ever since, it discharged this work only at one centre, and that at the request of the Bombay government. Consequently, the best legal opinion held that the Bank of Baroda was a commercial bank rather than a 'state-associated' bank *currently* fulfilling responsibilities on behalf of a government, and that its takeover could not be justified for the purposes in view. With the Bank, and later the Government of India, accepting this opinion, nine state-associated banks were now left in the fray.

Venkatappiah divided these nine banks into three categories. The first category comprised the State Bank of Saurashtra, the Bank of Patiala, and the Hyderabad State Bank. The first two were wholly owned by the respective state governments, while the Hyderabad state government owned more than half the share capital of the last-named bank. In other ways too, state control 'had been a feature of ... (the) development' of these banks. The second category comprised the Travancore Bank and the Bank of Indore, in both of which the governments concerned owned nearly a third of the share capital. It was expected that once the new states of Kerala and Madhya Pradesh came into existence, branches of the Travancore Bank in the former state and that of the Bank of Indore in the latter would be outnumbered by those of the State Bank of India. The third category comprised the other four state-associated banks. While essentially complementing the State Bank of India rather than competing with it, these banks represented a more widespread presence than the former in their respective areas of operation.

Responding to the view expressed in some quarters that the State Bank of India's energies and resources were already being strained by its heavy expansion programme and that it was not in a position yet to undertake major new responsibilities, Venkatappiah proposed bifurcating the takeover project from a 'pragmatic point of view'. According to his proposal, the State Bank of India would only take over state-associated banks in which the state governments already held a third or more of the capital, while the other four banks would be taken over by the Reserve Bank, both institutions running these banks as their subsidiaries and giving them the maximum possible autonomy to manage their operations under the supervision of local boards. Venkatappiah believed this solution would be acceptable to governments both at the centre and in the states, as well as to the wider community.

Public confidence in the banks will not only be preserved [thereby] but enhanced and the undesirable consequences which might arise if the State Bank [of India] were required to open a large number of branches, in the area of the respective States, could be avoided. Further ... the stage will have been set for pursuing a more rapid expansion of the currency chest system, and a basis laid, without sacrificing the good features of individual institutions, for the establishment of a ... strong countrywide banking structure

Rama Rau, who did not share Venkatappiah's enthusiasm for the takeover of all the nine state banks, favoured a more modest agenda. He proposed confining the takeover plan at least initially to the so-called Group I banks, i.e. the State Bank of Saurashtra, the Bank of Patiala, and the Hyderabad State Bank. The need for action in the case of the other six (Group II) banks, Rama Rau argued, was 'less urgent', and in the first instance the Bank might consider taking steps for 'more effective control' over these institutions while retaining them as its agents. Alternatively, he proposed that the State Bank of India could be allowed to extend to the major district towns in the Part B states, with the concerned state-associated banks existing as 'more or less "private" commercial banking institutions with little or no special control by the State'. The Governor preferred vesting the ownership and control of the Group I banks in the Reserve Bank, particularly as the State Bank which was already committed to opening 400 new offices within five years might be unable to cope with the additional responsibility. Clarifying his rather unusual suggestion to the Central Board later, Rama Rau pointed out that the State Bank's 'salary structure' being 'unduly high', takeover by it might greatly increase the establishment costs of the three banks. Local opinion too would feel more assuaged if these institutions maintained direct links with the Reserve Bank. However, the Governor was not averse to the State Bank of India taking over the Group I banks if it was 'willing and able' to do so.

Even as the government was considering Rama Rau's views, public and political interest in the future of state-associated banks was heightened in January 1956 when, at a meeting of the Standing Committee of the National Development Council, D.R. Gadgil deplored the delay in implementing the 'publicly announced policy decision' to establish an integrated State Bank covering the whole country. Gadgil's outburst and the Finance Minister's promise to the Standing Committee of early action appear to have persuaded the Finance Ministry to reject the Governor's watered-down plan and come down instead on the side of his deputy's revised plan of bringing all the nine state banks under the ownership and control of the Reserve Bank. Writing to

Venkatappiah soon afterwards, Patel regretted that the Bank and the government placed different levels of emphasis on the 'main considerations' involved. Not only was the Government of India committed to taking over all the state banks, particularly after the Finance Minister's reply to Gadgil, the former also felt, unlike Rama Rau, that the reorganization of states was 'virtually the most important and compelling reason for ... immediate action' covering all nine banks.

If we decide not to take over these banks and allow them to be converted into ordinary commercial banks, the State Bank will have to open branches in these areas and in particular at important centres at which these ... banks are functioning at present. The latter will thus have to meet severe competition which ... might easily endanger their stability, the more so as most of them will lose Government funds and patronage. ... the necessity for opening branches in these areas would also throw considerable additional strain on the State Bank and ... reduce the pace of expansion of the branches as a whole.

Patel's letter to Venkatappiah concluded by requesting him to obtain the Governor's orders 'quickly' and draw up a bill to nationalize all nine banks which could be introduced when Parliament convened for its budget session.

However Rama Rau dug in his heels and refused to yield on the future of his Group II banks. Seeking a 'reconsideration' of the recommendations of the Rural Credit Survey, he pointed out to Patel that nationalization of the state banks was only a means to an end, which was the 'acquisition of control over these institutions with a view to implementing government policies effectively'. But nationalization did not always translate into control: although the Imperial Bank had been nationalized, the Reserve Bank's control over it was 'less effective ... than over other scheduled banks'. The absorption of state banks into the Imperial Bank was earlier considered necessary as the means of acquiring a 'controlling interest in the Imperial Bank'. But with the Imperial Bank having come into public ownership through more direct means, state banks were no longer an intrinsic part of the integration plan. Secondly, once the State Bank of India emerged as a major presence in the reorganized states of Karnataka, Madhya Pradesh, and Kerala, the Mysore, Indore, and Travancore banks would cease to be vital to the programme of banking integration. In fact, he suggested, the latter could now be better achieved by establishing the State Bank of India's presence in the new areas of these states than by allowing state-associated banks to expand into them. The State Bank of India's expansion would not, contrary to the government's fears,

threaten the stability of these state-associated banks, the Governor argued, since it would not be in direct competition with any of them. The former did not for instance pay interest on deposits and maintained besides, 'very high standards' in the selection of loans for its portfolio. Reiterating his preference for confining immediate measures to the Group I banks, he adverted to the possibility of subjecting the Group II banks to greater control by the Bank so long as they conducted business on its behalf. Banks acting as the Reserve Bank's agent, the Governor suggested, should cede to the latter institution the power to appoint and remove their chairmen and chief executives, the right to secure and ratify amendments to their Memoranda and Articles of Association, and finally, powers to issue instructions on policy matters and impose special restrictions on the nature of the business they might undertake.

Rama Rau followed this up with a meeting with the Finance Minister early in February 1956. The Finance Minister initiated the discussion at this meeting by pointing out that the object of the Rural Credit Survey in proposing the takeover of state-associated banks would not be met by the State Bank of India expanding to the areas covered by them, since this would lead to avoidable duplication of banking facilities in some areas and reduce the overall extension of banking facilities. Nor could there be any question of Group II banks being allowed to withdraw from treasury and other state responsibilities. The State Bank's expansion to 'cover *new* areas' was necessary to promote currency chest arrangements, and nothing should be done to force it to spread its resources too thinly across areas where other banks were better placed to offer similar facilities. Besides, once the legal classification of state-associated banks (that they should have a history of association with states *and* be currently undertaking treasury and agency work on behalf of governments) was accepted as a basis for action, the Finance Minister pointed out, 'all ... banks falling within the definition should be taken over without exception'. Rama Rau did not depart from the views he had communicated to Patel and insisted that practical considerations prevented the Reserve Bank from taking over more than three banks in the immediate future. The Finance Minister argued that the Bank's preference pointed in the direction of a narrow and exclusive definition of state-associated banking and that once accepted, this definition could not be widened to cover the other six banks. Bearing in mind the Governor's practical difficulties, however, the Finance Minister proposed a twofold classification of state-associated banks: one category comprising banks in which the state governments concerned owned half or more of the capital and the second category comprising the other six banks. He yielded to the Governor's view that the latter category of banks should not be taken over immediately, but insisted on their being classified as 'state-associated' banking

institutions so that the government remained free to review their position at a later stage if circumstances so warranted.

Soon after this decision was taken, the Attorney General advised the government that while the State could take over the Hyderabad, Patiala, and Saurashtra banks, it could not arm itself with special powers that would be confined in their application to the remaining six (i.e. Group II) banks. The situation thus created was discussed at a meeting between Rama Rau and Deshmukh towards the end of March 1956, at which the latter pointed out that the Attorney General's view left the government with two alternatives—'to leave these banks alone or take them over'. Rama Rau, who had 'enough on his plate', remained unrelenting in his preference for the former course. Nor was he averse, he told Deshmukh in answer to a 'direct question', to Parliament being told that these banks were not being taken over because the 'Reserve Bank did not feel confident' of managing them. Finally, however, the Governor and the Finance Minister agreed that while immediate legislative action would be confined to the Group I banks, the position of the other six banks should be reviewed at the end of one year, and that a 'formula' would be drawn up to enable the government to take the latter over 'if and when' it decided to do so. It was also agreed that the State Bank of India would not open any branches in the areas covered by these banks in the meantime, and that the Reserve Bank would enter into agency arrangements with the Mysore and Travancore banks.

Towards the end of May 1956 the Union Cabinet approved in principle the decision to take over the ownership and management of the Hyderabad, Patiala, and Saurashtra banks and entrust these institutions to the Reserve Bank of India. The Bank's Central Board also approved the proposal in June 1956 and the bill to take over the three state banks was quickly drafted. Though prolonged by differences regarding methods of valuing the three banks, consultations with state governments over compensation also reached a decisive stage. At this point the Prime Minister, Jawaharlal Nehru, intervened to suggest that the legislation covering these institutions should contain a clause enabling the government or the Bank to take over the other (Group II) banks 'whenever ... necessary'. On being apprised of the latest turn of events, the Governor advised the Finance Ministry that apart from the merits of the question, any effort to widen the scope of the bill would delay legislation since it would now have to be extensively redrafted to include another definition of state-associated banks and some indication of the basis on which shareholders of the remaining six institutions would be compensated. The delay, the Governor pointed out, would come in the way of the three banks being taken over before the states were reorganized, and this would have particularly serious

implications for the Hyderabad State Bank and for the banking and treasury arrangements managed by it.

As events transpired, however, the original bill to take over the Hyderabad, Patiala, and Saurashtra banks had to be narrowed rather than widened. Parliament had before it a bill for amending the Constitution to enable state governments to carry on any trade or business relating to matters included in the Union list. Once approved, the amendment was expected, among other things, to remove the constitutional difficulty which the original bill to take over the Group I banks was intended partly to address. Hence, as a memorandum to the Union Cabinet pointed out, the decision to abandon the 'experiment of decentralized nationalization of banking' in Patiala and Saurashtra and take the two state banks into the Reserve Bank's ownership, deserved to be 'reconsidered'. Local opinion too, favoured retaining the banks under their present owners; while the chief ministers of the two states agreed to the Banking Companies Act and the Reserve Bank of India Act being extended to these institutions, and to the State Bank of India extending its activities to their states. However, the memorandum maintained, it was necessary to proceed with the nationalization of the Hyderabad State Bank as originally proposed since it was 'on a wholly different footing'. Unlike the other two banks, the Hyderabad State Bank was not a 'well-conducted concern'. Besides, since Hyderabad state would soon be split into three parts, the division of its assets and liabilities and the transfer of its management presented major difficulties; the division of the state would also throw its 'financial and banking machinery ... out of gear'. These contingencies would be averted if the central government took over the bank, the memorandum argued.

The same memorandum to the Union Cabinet was also in favour of the government declaring its policy towards the Group II banks in 'somewhat more definite terms' than was proposed earlier. The Reserve Bank, it admitted, was 'never happy about the proposal to take over the State-associated banks'. There was 'no compelling necessity' to acquire these banks to extend rural credit nor for the Reserve Bank to spend its limited manpower resources to take over and run these institutions. Nor was it 'quite appropriate for [the] Government to keep the banking companies, in question, in a state of suspense'. Hence the memorandum advised the Cabinet to decide against 'proceed[ing] further' with nationalizing the other six banks too 'for the present'. These proposals were 'seen and approved' by the Prime Minister.

The Cabinet met on 27 August 1956 to approve the decision to take over the Hyderabad State Bank, the proposal to pay compensation to the bank's shareholders at the rate of about Rs 94-4-6 for each share having a face value of Rs 85-11-5, and that to leave the Patiala and Saurashtra banks to be

managed by their respective state governments. Despite the Prime Minister having earlier approved the proposal, the Cabinet turned down the recommendation of the Cabinet Memorandum concerning the Group II banks and decided that their nationalization 'may be further examined later in consultation, if necessary, with the State Bank of India'.

The draft bill for taking over the Hyderabad State Bank was ready, but a heavy parliamentary schedule prevented it from being taken up for consideration. At the Bank's recommendation, the government promulgated an ordinance in September 1956, taking over the bank from 22 October the same year, and vesting its ownership and management in the Reserve Bank. The State Bank of Hyderabad bill came up for consideration in November 1956 and was passed the same month by both houses of Parliament.

THE AD HOC COMMITTEE'S PROPOSALS

Within months of this, however, debate revived about the future of state-associated banking. Rama Rau's resignation in January 1957 marked a decisive shift in the balance of opinion on the issue within the Bank. Venkatappiah had always been an enthusiastic advocate of takeover, and it was his view which now began to prevail in the corridors of the Bank. K.G. Ambegaokar, who held the fort for some weeks after Rama Rau vacated office, did not have strong views on the subject, and appears to have been willing to be guided in regard to it by Venkatappiah; while H.V.R. Iengar, who succeeded Rama Rau as Governor after having earlier been the Chairman of the State Bank of India, was sufficiently impressed by its 'new look' to support a scheme intended to strengthen his former institution's ability to expand credit to agriculture and small-scale industry. T.T. Krishnamachari, who stepped into Deshmukh's shoes as Finance Minister after a short interval, was initially averse to taking over state-associated banks. But he soon changed his mind, and once convinced of the necessity of bringing these banks under public ownership, Krishnamachari infused the whole endeavour with his characteristic sense of urgency and purpose.

Secondly, whether or not it was so intended by TTK who was the force behind the move, the future of state-associated banks dovetailed quite neatly into a new exercise aimed at equipping the State Bank of India to function as an 'instrument of national policy' rather than merely as a commercial bank. An ad hoc committee comprising senior officials of the Bank and the State Bank of India was set up to prepare proposals towards this end, but this committee also helped lend focus to simmering apprehensions within the Reserve Bank about the uncertainty and complications arising from existing

forms of ownership and regulation of the major state banks and of their association with banking and treasury arrangements in the states. As Venkatappiah wrote to H.M. Patel towards the end of February 1957, the problems which cropped up in several of the states in which the major state-associated banks and the State Bank of India operated could not be resolved unless their relative roles were defined with greater clarity. For example, the Punjab government which now owned the Bank of Patiala wanted the latter to be appointed as the Bank's agent in the former PEPSU area. The Bank felt the state government's suggestion could not be examined except with reference to the State Bank of India's place in the area and the advisability of entrusting currency chests to a state government or a 'banking institution under its control'. In Kerala and Mysore too, uncertainty over the roles likely to be assigned to the respective state-associated banks in different parts of the two states inhibited the State Bank of India's expansion into them. While banking and treasury arrangements might eventually have to be entrusted to more than one bank in some of these states, the Rajasthan government, on the other hand, was finding the 'present complex arrangements for the management of Government accounts through several banks ... highly inconvenient'. Since the State Bank of India could not reasonably be expected to cover the whole state except after great delay and expense, the state government proposed reviving earlier efforts to amalgamate the major state-associated banks in the state.

In addition, the Bank was already experiencing difficulties in regulating the activities of the Patiala and Saurashtra banks which did not bode well for the future. It transpired that, contrary to an undertaking given by the former PEPSU government that it would confine its activities to the former PEPSU area, the Bank of Patiala opened a branch at Chandigarh without consulting the Bank. It required the central government's intervention to put an end to the bank's plans to expand to several other centres outside the PEPSU region. Similarly, the State Bank of Saurashtra was 'no longer content' to confine its operations to the former Saurashtra state, and was making efforts to expand to centres such as Bombay and Ahmedabad. Besides, the bank continued to hold large government balances, albeit as a transitional measure, contrary to the agreement between the Bank and the Government of Bombay.

In the Bank's view as it prevailed and was communicated to the Government of India at the end of February 1957, three sets of issues hung fire. The first related to agency arrangements, particularly in the former Part B states. The case for appointing state-associated banks as agents in the latter states had no doubt weakened following the reorganization of states. On the other hand, these banks served in agency roles at nearly two-thirds of the treasury and

subtreasury centres in the five states where they operated—Punjab, Bombay, Mysore, Kerala, and Rajasthan. The second pertained to the State Bank of India's expansion programme, involving the opening of 400 branches in five years. This target was fixed on the assumption that the state-associated banks would be integrated with the State Bank of India. If the former were 'left out' of the integration scheme and the main burden of expanding rural credit facilities entrusted to the State Bank of India, it would have to divert some of its energies to opening branches at the 163 treasury and subtreasury centres where the former alone had a presence. Consequently, even after 400 new branches were opened, the goal of an integrated 'countrywide [banking] network' would remain elusive.

The third issue related to the need for developing currency chest and remittance facilities and the desirability of transferring responsibility for managing the former from state governments to the State Bank. Progress in opening currency chests in the former Part B states remained very slow, largely because state-associated banks were generally not 'strong enough to assume the ... risks and responsibilities' of managing currency chests. Once again, therefore, the situation pointed in the direction of taking steps to strengthen state-associated banks and equip them to complement the efforts of the Reserve Bank and the State Bank of India to expand credit to small borrowers in rural and semi-urban areas, provide efficient remittance facilities, and manage agency and treasury arrangements.

The ad hoc committee, which comprised the Governor, H.V.R. Iengar, as its chairman, Deputy Governors Ram Nath and Venkatappiah, D.R. Gadgil, and P.C. Bhattacharyya, Chairman of the State Bank of India, finalized its report in June 1957. It recommended extending the pattern of agency and treasury arrangements obtaining in the Part A states to the former Part B states. It rejected the idea of state governments continuing to maintain deposits and independent relations with banks for transacting government business, except as a purely transitional measure, and recommended the termination of such arrangements where they existed. The committee believed the three issues which the Bank raised with the government in February 1957 were best addressed by utilizing the 'existing machinery' of state-associated banks 'to as large an extent as possible' in order to supplement the activities of the State Bank of India. Towards this end, the committee recommended the transfer of the control of state-associated banks to the central government or an institution controlled by it. It was also in favour of preserving the functional autonomy of these banks whilst bringing their operations under the control and supervision of the State Bank of India.

In practical terms, this meant converting all the major state-associated banks into subsidiaries of the State Bank of India. The committee viewed the Reserve Bank's ownership of the Hyderabad State Bank as a 'stop-gap' arrangement and saw no reason why this bank too should not be transferred to the State Bank of India and constituted as its subsidiary. The plan to constitute the major state-associated banks as subsidiaries of the State Bank of India would secure for the country 'one integrated, centralized organization for the management of treasury arrangements and currency chests' while retaining 'all or ... most of the advantages that are available at present to the people of the areas ...' covered by these banks. However, for practical and administrative reasons and so as to avoid any 'psychological effect of the wholesale implementation of the policy on the general economic situation in the country', the committee recommended carrying out the reform in stages. In the first stage, state-associated banks in which state governments owned a quarter or more of the capital (the Bank of Patiala, the State Bank of Saurashtra, the Bank of Indore, the Bank of Jaipur, and the Travancore Bank) were to be taken over and reconstituted as subsidiaries of the State Bank. The question of integrating the remaining three banks (the Bank of Bikaner, the Bank of Rajasthan, and the Bank of Mysore) was to be 'considered in due course but without undue delay'. In the meantime, the State Bank of India was free to negotiate the takeover of these institutions by mutual agreement. While allowing existing treasury and currency chest arrangements to continue in the areas served by these three banks, the committee declared that 'eventually, no bank other than the State Bank, together with its subsidiaries, will be allowed to act as the agent of the Reserve Bank or to retain currency chests'.

Communicating the main recommendations of the ad hoc committee to the Finance Minister, Iengar suggested that the next step of framing the necessary legislation should be taken up after the Central Boards of the Bank and of the State Bank of India had had a chance to consider the report. The Deputy Governor followed this up by adding that local sentiment in Mysore actually favoured the takeover of the Bank of Mysore as a subsidiary of the State Bank of India, and that the Government of India should take this 'marked feeling' into account in its deliberations.

With plans afoot to introduce legislation in the monsoon session of Parliament to implement the first stage of the ad hoc committee's reforms package, Iengar convened a special meeting of the Bank's Central Board in July 1957 to discuss it. The Governor's memorandum pointed out to the Board that the committee's recommendations were not a 'prelude to the nationalization of commercial banks in the country'. Unless they were

implemented, it would not be possible to set up a countrywide banking network nor create a banking institution which could act as an 'instrument of national policy'. Iengar also underlined that the setting up of currency chests and provision of remittance facilities were being hindered by the absence in many areas of suitable banking institutions, and drew attention to some 'highly dangerous' trends in state governments' handling of currency chests. 'Unauthorized raids on these chests are already considerable and it looks as if with deficit budgets, such raids may become larger and more frequent in future.'

The Board refused to withdraw from its earlier position on the takeover of state-associated banking. It accepted a part of the committee's recommendations and agreed that the Patiala, Saurashtra, and Hyderabad banks should be constituted as subsidiaries of the State Bank of India. While five members of the Board agreed with the proposal to nationalize the Bank of Indore, the Bank of Jaipur, and the Travancore Bank and constitute them as subsidiaries of the State Bank of India, six other members felt 'compulsory legislative action' was 'undesirable' for the end in view, and that 'acquisition or taking over of control of these banks should be settled by negotiation'. The Board also asked to be consulted before fresh legislative measures were undertaken to deal with the Mysore, Rajasthan, and Bikaner banks. As the Governor explained the reasoning of these six members later to H.M. Patel, they regarded the proposal as 'merely the thin end of the wedge towards nationalization of banks'. They also felt 'compulsory legislative action [was] "undemocratic"—whatever that means'. According to Iengar, some members advised the Bank and the government to buy up the shares of state governments and of private shareholders willing to sell, and thus come into the ownership of a majority of the shares. Although, under the Banking Companies Act, this would not translate into actual control, they felt the government would nevertheless be justified thereafter in converting these banks into subsidiaries of the State Bank of India.

Remarking to Patel on the sharp divisions within the Board, Iengar felt opposition to the ad hoc committee's proposals might reflect wider opinion in the country and could have some effect on overseas reactions as well. It would not have been difficult for him to 'brandish the big stick' and get the Board's approval. 'A couple of members would then have changed their votes'. But he refrained from such tactics since he wanted the Board to 'express its views with complete frankness and freedom'. With the State Bank Board having agreed to the proposals, the government was free to go ahead with the necessary legislation. 'If it were purely a domestic matter, I would have strongly recommended ... taking such a course because I do not think the six members ... are really right.' However it was also necessary to

consider the effects of such a move on 'opinion in places like London, New York and Washington ...' which would depend to some extent on the reaction within India.

If some of our people said the ... step was unwise and was a prelude to [the] nationalization of commercial banks, the cry would be taken up in foreign centres and that, however misguided, would be most unfortunate from our point of view.

Underlining the importance of devoting some thought to the 'public relations aspect' of the takeover, Iengar pointed out that little would be lost in deferring the move for the time being since in any event, Parliament would have no time to pass the legislation in the current session. In the meantime, he proposed, the Life Insurance Corporation should be told to purchase shares of the Jaipur, Indore, and Travancore banks 'in suitable lots (as and when they become available) at reasonable prices, and without undue publicity'.

Following the Bank's advice, the government decided initially to bring forward a bill to take over only the Saurashtra, Patiala, and Hyderabad banks. The Bank drafted the necessary legislation in August 1957. But even as this piece of legislation was receiving finishing touches in November, T.T. Krishnamachari expressed surprise that it 'left out' the Jaipur, Indore, and Travancore banks. According to the Finance Minister, 'a slight delay' in moving the legislation was a 'small price to pay for avoiding the trouble of having to pilot two bills through Parliament' in quick succession. Since it was proposed to take over all the six banks, the Ministry demanded 'one consolidated bill'. This request reached Bombay on 12 November and without it appears much demur, the Bank drafted and despatched the modified bill to New Delhi on 23 November. However, in a personal meeting with the Finance Minister in Madras early in December 1957, Iengar impressed upon him once again the need to educate the public about the 'special reasons' for the bill, and for 'disabusing them of any impression that this was the beginning of a programme of nationalization of commercial banks'. Iengar also agreed to 'help [the government] in this public relations task'.

This exercise also ran into rough weather almost at the outset. The Punjab government opposed the move to take over the Bank of Patiala which it said was a scheduled bank adhering to all the relevant provisions of the Banking Companies Act and functioning efficiently under the supervision of the Reserve Bank whose nominee sat on the Board of Directors. Describing the decision as a 'rude shock', the Punjab government maintained that takeover by the central government or any of its agencies would rob the Bank of Patiala of its regional character and 'upset the economy of the area with whose prosperity

... [it] has been so closely linked for over 40 years'. As it happened, however, this piece of legislation never made it to law. It was tossed aside by the storm created by the Mundhra affair which also swept T.T. Krishnamachari and H.M. Patel out of office. The new Finance Minister, Morarji Desai, was not as enthusiastic as his predecessor about nationalizing privately-owned state-associated banks (viz. the Jaipur, Indore, and Travancore banks) against their will, so that once again the search began for other ways in which these institutions could be brought under public ownership.

VOLUNTARY TAKEOVER OF STATE-ASSOCIATED BANKS

One idea which was canvassed was for the State Bank of India to acquire a majority stake in these institutions by purchasing their shares. This was quickly rejected as impractical. There was no market as such for the shares of some of these banks. In other cases, the market was thin or the shares were very tightly held. Although state governments and publicly-owned institutions such as the Life Insurance Corporation held a significant interest in many of these banks, the State Bank would still have to make substantial purchases of stock from the market where one existed, to acquire majority ownership. Such purchases, the Bank's Department of Banking Development calculated, would range from 17 per cent of the stock in the case of the Bank of Indore to 51 per cent in the case of the Bank of Mysore and the Bank of Rajasthan. However discreet the intervention, purchases on this scale would inevitably publicize the State Bank's interest and drive up the prices of these banks' shares 'to fantastic levels'. Even should the State Bank succeed in acquiring 51 per cent of a bank's stock, it would, unless exempted from its provisions, be prevented by the Banking Companies Act from exercising 'effective control' over the working of such a bank.

The other solution proposed was to take over the state-associated banks with the consent of their shareholders. Strongly advocating this course after being told of the impracticability of the State Bank acquiring the stocks of these institutions from the market, Iengar noted in June 1958 that 'two points' were 'clear' to him. The first was that the idea of the State Bank operating state-associated banks as subsidiaries should not be 'abandoned'. The bank, which had begun taking an interest in the cooperative movement and in small industries, now had a 'new look' about it. Other banks could not be expected to organize their affairs to support government policies in the same way. Areas covered by state-associated banks could also benefit from the presence of the State Bank of India if it started opening branches there, but that would

be a 'lengthy and difficult' route to adopt. Therefore he was 'driven to the conclusion that the State Bank must get control over the functioning of these banks'. The only way of doing so was to acquire a 'controlling interest in the share capital of these institutions'.

At the same time, 'if it is possible to avoid compulsion, it is better to avoid it ... as a matter of public relations' Hence Iengar turned, with the Finance Minister's agreement, towards the possibility of persuading shareholders of state-associated banks to pass resolutions consenting to their institutions being taken over by the State Bank and operated as its subsidiaries. Two alternatives were canvassed in this connection. The first proposal, which found favour with the Bank's Legal Division, was for the banks concerned to move the courts under section 391 of the Companies Act for an 'arrangement' between themselves and shareholders to transfer 75 per cent of their stock to the State Bank of India. The State Bank of India responded with little enthusiasm for this scheme which it felt was 'full of uncertainties and ... obstacles at each stage'. It was far from certain that courts would intervene in the affairs of banks which were not suffering from 'mismanagement or malpractice', or that they would regard it 'in the public interest' for shareholders of a bank to 'part with their investment'. Even should a court yield to the State Bank's plea on both counts, the right of appeal could not be denied to a shareholder. Unless terminated by legislation of the sort which the Reserve Bank and the State Bank wished now to avoid, the proposed course would lead to litigation and put off indefinitely the consummation of the whole project. The task of imposing some uniformity on the banks' constitutions and organizations after they were taken over would also be prolonged by wrangling and litigation. According to Bhattacharyya, these obstacles were potentially so formidable that he was prepared, should recourse to the Indian Companies Act offer the only way of achieving their voluntary takeover, to leave the privately owned banks 'altogether' out of the integration scheme and expand the State Bank's activities 'to cover the areas in question within a reasonable period'.

The State Bank's own preference was for proposing to all banks that they should pass shareholders' resolutions 'indicating their willingness to be taken over as subsidiaries of the State Bank of India' and stipulating broad conditions about compensation and the size of the 'minority' stake. Banks which passed resolutions agreeing to the takeover, Bhattacharyya proposed, could be included in the existing draft legislation. This proposal would give all subsidiary banks a statutory character and uniform constitutions without recourse to prolonged legal or other action, and ease the State Bank's task of administering them. In conveying this proposal, Bhattacharyya suggested informing state-associated

banks that they stood to lose government business and balances if they insisted on retaining their present ownership and management, and face competition from the State Bank of India in their areas of operations.

Iengar was quick to spot the merits of Bhattacharyya's proposal and commend it to the Finance Minister. The government's 'good offices', the Governor told Desai, was 'required in very large measure' to persuade the banks to pass the intended resolutions. With the Finance Minister also accepting the proposal, Bhattacharyya wrote to the six privately owned state-associated banks explaining the features of the latest takeover scheme and suggesting that they secure appropriate resolutions from their shareholders. The Bank of Rajasthan, the majority of whose shares was closely held by a few members of one family, was determined to avoid the State Bank's embrace. But shareholders of the other banks passed resolutions as suggested. There was a minor scare in the case of the Bank of Mysore after some shareholders, led apparently by three directors of the bank, changed their minds and demanded to reconsider the earlier decision favouring the takeover plan. But the Chief Minister and Finance Minister of the state remained firmly committed to the original resolution, while it also turned out that the new demand was not as representative as it had seemed earlier. In the event, the resolution opposing the takeover was not pressed when the extraordinary meeting convened. At the same time, a petition in the local High Court disputing the takeover was also withdrawn.

The State Bank of India (Subsidiary Banks) Bill, 1959 was introduced in Parliament on 4 March 1959, and was referred to a Joint Select Committee at the end of April 1959. The bill, as amended by the Select Committee, was passed by the Lok Sabha on 12 August 1959 and by the Rajya Sabha the following week. With the President assenting to the legislation early in September 1959, the decks were cleared at long last to take over the major state-associated banks, vest their ownership in the State Bank of India, and reconstitute them as its subsidiaries. Having already come under the Bank's ownership, the State Bank of Hyderabad presented the least complications. It was the first state-associated bank to be reconstituted as a subsidiary of the State Bank of India, commencing business in that capacity on 1 October 1959. The State Banks of Bikaner, Indore, and Jaipur came into existence on 1 January 1960, and the other subsidiary banks were established during the course of the next few months. The State Bank of India's holdings of the shares of the new institutions ranged from 100 per cent in the State Banks of Hyderabad, Patiala, and Saurashtra, to just over 81 per cent and 75.5 per cent respectively in the State Banks of Indore and Travancore, and about 58.5 per cent in the State Bank of Mysore.

As proposed by the ad hoc committee, compensation for the banks taken over was negotiated on the basis of their net worth. In the Governor's words, the compensation amounts as finally determined were 'virtually in the unanimous opinion of the shareholders concerned ... exceptionally fair, if not generous'. The ad hoc committee had suggested three ways in which to finance the State Bank of India's acquisition of the six state-associated banks which were originally proposed to be taken over. The Bank's Central Board recommended that the State Bank should raise the entire amount by issuing shares with a face value of Rs 100 to the Bank at a premium of Rs 250, and credit the realized premium to its Reserve Fund. The State Bank, on the other hand, was keen to avoid financing the entire take-over by raising fresh capital and proposed instead to raise Rs 75 lakhs in the form of fresh capital contributed by the Bank, and borrow the remainder from the latter in the form of long-term deposits. The State Bank's plan was also approved by the central government.

However, circumstances had changed considerably by the time the take-over scheme came to fruition. The number of banks intended to be taken over increased to eight, and in the case of five of these banks, the Subsidiary Banks Act allowed private shareholding of up to a maximum of 45 per cent. The State Bank of India also having stepped up its dividend in the meantime from 16 per cent to 20 per cent, it was apprehended that its dividend liability on the additional shares might substantially exceed its income from the subsidiary banks. Therefore it was decided that the Bank would place the entire compensation amount, as and when it became payable, in the form of long-term deposits with the State Bank of India at rates of interest to be determined after some idea had formed of the latter's likely income from its subsidiaries. The committee of the Bank's Central Board was not enthusiastic about this suggestion and expressed surprise that the State Bank could not find the necessary resources on its own without recourse to the country's central bank. But with the Government of India also approving this arrangement, the Reserve Bank agreed to finance the State Bank's acquisition plans in the manner suggested by it.

The first request for a long-term deposit was for Rs 80 lakhs to acquire the State Bank of Hyderabad which, until then, was owned by the Bank. In all, the Bank placed with the State Bank fixed deposits aggregating Rs 6.8 crores, representing the compensation paid by the State Bank of India to shareholders of the eight state-associated banks. In 1961 and again during the following year, the Bank briefly considered converting the deposits gradually into shares of the State Bank, but this proposal appears not to have found favour with the latter institution. It was decided thereafter to arrange for the deposits to be repaid at

an early date, but repayment too was put off as a concession to the State Bank's view that the deposits should be maintained until the subsidiaries started yielding a steady return in the region of about 6 per cent per year. Finally in 1965, the Bank decided in consultation with the State Bank to withdraw these deposits in a phased manner. Withdrawal commenced in January 1967 in three roughly equal annual instalments, and was completed in January 1969.

When the time came to determine the interest payable on these deposits, the State Bank took the view that apart from being reimbursed for the expenditures it incurred in taking over and administering its subsidiaries, it was also entitled to be remunerated for the management services it provided to them. After allowing for both, it proposed paying the Bank an interest of 1.5 per cent on its deposits. Justifying the demand for remuneration, the State Bank argued that its superior management equipped the subsidiaries to discharge government business and treasury functions. Besides 'the entire ramifications' of the bank were placed at their disposal, and the 'cost of these services' could not be estimated. The State Bank's association was also a source of strength to the subsidiaries and gave them access to 'tangible facilities and concessions'. Therefore remuneration accorded with 'normal business principles'. Although the State Bank would have preferred a remuneration of 5 per cent of the dividends accruing to it from the subsidiaries, that would have left it just enough to offer the Bank a mere quarter per cent on its deposits in 1960-61. Hence it proposed remunerating itself to the extent of 2.25 per cent of the dividends it received from the subsidiaries, so that the Bank might be paid an interest of 1.5 per cent on its deposits.

Many officials of the Bank felt the latter rate was unjustifiably low, more so as the State Bank's proposal amounted to remunerating itself for running the subsidiaries before paying its creditors their dues. Questioning the 'basic philosophy' underlining its arguments, the Chief Accountant noted that it should pay the Bank a rate of interest closer to what it would have paid other depositors lending for a similar term. The subsidiaries the State Bank had acquired were 'running concerns having a large network of branches' which would increase its future 'strength and earning capacity'. Therefore, the Chief Accountant remarked, the

basis on which the rate is now being calculated, viz. that the State Bank is managing these subsidiary banks not as Principal, but something like Managing Agents entitled to their charges and commission from the very outset of the setting up of the businesses even by depriving the creditor of a 'fair' return on the funds lent by it, hardly appears appropriate to the circumstances of the case.

The Bank accepted the State Bank's proposals, including those for management remuneration, in 1961. However, following extensive internal discussions, it decided in 1962 that while the State Bank could reimburse itself for the cost of running the subsidiaries, it was not entitled to be 'remunerated by way of commission for looking after the subsidiary banks'.

SOME SUBSIDIARY ISSUES

Soon after they came into existence, the Bank's attentions were engaged by the need to consolidate the subsidiary banks in Rajasthan. Inspections by both the Reserve Bank and the State Bank revealed the weak position of the State Bank of Jaipur and its inability to bring about immediate improvements and survive viably as an independent unit. Besides, Rajasthan was the only state to have two subsidiary banks of the State Bank of India and diseconomies arose from the fact of both institutions having offices at several common centres. The combined unit, it was also expected, would become the largest of the State Bank's subsidiaries and offer an attractive magnet for other weak banks in the area to merge with it.

As the State Bank held 94 per cent of the equity of the Bikaner bank and 98 per cent of that of the Jaipur bank, the two institutions could in principle be amalgamated under Section 38 of the State Bank of India (Subsidiary Banks) Act. Talks to consolidate the Rajasthan subsidiaries began not long after they changed status, but the State Bank of India preferred to defer any action on them until the reforms it contemplated in the management and working of the State Bank of Jaipur had had some chance to take hold. Finally towards June 1962, the State Bank sent the Reserve Bank a draft scheme proposing amalgamation of the two institutions through one of the banks acquiring the business of the other. But the Bank's Legal Adviser believed this course to be fraught with legislative and legal complications. Following this, the State Bank proposed amalgamating the two institutions as in its original proposal, while deferring consequential amendments to the Subsidiary Banks Act to a later date. The new Governor, P.C. Bhattacharyya, felt any legislation necessary should be enacted promptly and that it would not be wise in its absence to extinguish the Bank of Jaipur. Finally, after some deliberation, it was decided to adopt the scheme for amalgamation proposed by the State Bank and take up with the government the question of amending the Subsidiary Banks Act, so that both the amalgamation and the amended legislation came into effect on a common date. It was agreed in discussions between the Governor, the Finance Minister, and the Chairman of

the State Bank of India to name the new bank the State Bank of Bikaner and Jaipur, and locate its headquarters at Jaipur. With the Boards of the two banks agreeing upon the new name in September 1962, the government formally sanctioned the amalgamation scheme in December and specified 1 January 1963 as the takeover date. The necessary legislation, which included among other things provision for the orderly winding up of two minor state-associated banks, viz. the State Bank of Dholpur and the State Bank of Kurundwad (Junior), came into effect in December 1962. The Bank of Rajasthan however stood its ground and survived as a private sector bank.

Once the process of taking over the state-associated banks was completed, proposals were mooted to merge the subsidiary banks with the State Bank of India. Although the Reserve Bank and the State Bank of India discussed the issue in 1963–64 and the matter was raised in Parliament in 1964, the issue came to the fore in 1967 after a private member's bill proposing the merger of the subsidiary banks with the State Bank of India was tabled by Ramkishan Gupta. The Bill was referred to the Bank for its comments. The State Bank of India, whose views were also sought, recalled the background to the conversion of the Imperial Bank into the State Bank in 1955, the creation of the subsidiary banks, and the consideration given to the subject jointly in discussions with the Bank in 1963–64. Following these discussions, a tentative scheme was prepared to merge the subsidiary banks. This was shelved subsequently in favour of amending the State Bank of India Act to give wider powers to local boards. Replying to the debate on the State Bank of India Amendment Bill, 1964, the Finance Minister, T.T. Krishnamachari, pointed to reports he had received that customers got better facilities from the subsidiary banks than they did from the State Bank of India. In general too, there had been a palpable improvement overall in the functioning of the subsidiaries both in their conventional operations and in the extent of their involvement in developmental activities. It was felt no significant purpose would be served by merging the subsidiaries with the State Bank of India. These matters have remained until this day.

With the extension of the Reserve Bank of India Act to the whole of India, the question of the Bank undertaking banking business for the Jammu and Kashmir state government came up for consideration. When the question of entering into an agreement with the state government under section 21A of the Bank Act was considered in 1959, the Bank and the Government of India concluded that 'it would be unwise' to entrust currency chests to the state government and place 'banking arrangements with the state on par with those of other states' until its administration 'particularly the treasury and accounting side ... settled down'. Besides, in the Bank's view, agreements with other

states were not working 'quite satisfactorily', and state governments were using the Bank for 'unregulated overdrafts'. Hence the Bank felt it was 'not desirable to place this temptation in the way of the Jammu and Kashmir State'.

The Jammu and Kashmir Bank was the banker to the state government. A non-scheduled bank incorporated in 1938, nearly two-thirds of its paid-up capital was contributed by the Jammu and Kashmir government. The latter had three nominees on the bank's Board, one of whom was its Chairman. A government company under the Companies Act, 1956, the bank had entrusted to it the state government's treasury work at Srinagar and eight other places in the state. The government and institutions associated with or controlled by it also held substantial deposits with the bank and borrowed funds from it on a large scale. Successive inspections by the Bank's officers revealed that the financial position of the Jammu and Kashmir Bank was extremely unsatisfactory. In 1959 the Bank found that the Jammu and Kashmir Bank's paid-up capital and reserves (including undistributed profits) amounting to nearly Rs 15 lakhs had been wiped out, and that its deposits had been affected to the tune of Rs 6.72 lakhs. The inspection also revealed major defects in the bank's investment and advances portfolio, earning capacity, and head office supervision and control over its branches. Apart from issuing directions, the Bank also deputed an officer to the Jammu and Kashmir Bank to study the latter's working and recommend ways of placing the institution's administration on a sounder footing. Little came of this, however, as the bank took 'no concrete steps ... to implement' the officer's recommendations. The Bank's subsequent inspections revealed no improvement in the affairs of the Jammu and Kashmir Bank, and the latter was then judged ineligible for a licence under the Banking Companies Act.

The situation in Jammu and Kashmir was thus quite anomalous. However its affairs were conducted, the Jammu and Kashmir Bank was in almost every sense of the term a 'state-associated' banking institution. But not only had this institution not benefited from the organizational and operational reforms carried out of the other major state-associated banks, the State Bank of India, which did conduct the central government's treasury business to a limited extent in Jammu and Kashmir, was a relatively negligible presence in the state. The possibility of the State Bank of India taking over the Jammu and Kashmir Bank was raised by the state government with the State Bank Chairman, P.C. Bhattacharyya, in October 1961. In deliberating upon this suggestion, the Reserve Bank concluded that in principle two distinct questions had to be tackled: firstly, whether it should agree to become banker to the state government, and secondly whether it should appoint the Jammu and

Kashmir Bank as its own agent in the state. In practice, however, it was impossible not to conflate the two issues since in the event of the Bank agreeing to become the banker to the state government, it could not depart from the convention it had adopted in the other states of appointing the local state-associated bank as its agent, particularly once it was taken over by the State Bank. Should the precedent adopted in other states be followed in Jammu and Kashmir as well, it would be 'difficult to resist the J & K Bank having charge of the currency chests'. By now state governments' overdrafts had become a major problem and the Bank would soon consider relinquishing its role as banker to chronically overdrawn states. As the Governor, H.V.R. Iengar, put it, the Reserve Bank already had

so much trouble with other State Governments regarding the misuse of the currency chests that it is undesirable to add one more State to our list if we could possibly avoid doing so.

Hence the Bank and the Government of India decided that the State Bank of India 'might go slow in the matter of ... taking over the J & K Bank as a subsidiary'. In the event, the preferences of the Bank and the Government of India coincided with those of the Jammu and Kashmir government. A committee appointed by the latter to examine whether the Jammu and Kashmir Bank should be reconstituted as a subsidiary of the State Bank of India did not favour the proposal on the ground that a local institution such as this bank was needed to finance the trade and commerce of the state. It also recommended that the state government should continue to conduct its business through the Jammu and Kashmir Bank.

EPILOGUE

The prolonged process of reorganization of the former state-owned banking institutions drew to an end with the merger of the Bank of Baghelkhand, the Mayurbhanj State Bank, and the Manipur State Bank with the State Bank of India. The Sangli Bank, on the other hand, followed the example of the Bank of Rajasthan and decided to plough its own furrow as a private commercial bank.

The activities of the subsidiary banks of the State Bank of India expanded rapidly after they came into existence. Starting out with 328 offices, they opened, between themselves, over 430 new branches between 1960 and 1967. Aggregate deposits rose from Rs 103 crores to Rs 280 crores and total advances from Rs 59 crores to Rs 162 crores between 1960 and 1967. Advances to the agricultural sector rose steeply from about Rs 62 lakhs in 1960 to Rs 2.17

crores the following year. It stayed at that level for the next two years, and after hovering around Rs 3.5 to 3.75 crores between 1964 and 1966, rose once again to Rs 6 crores in 1967. Advances to the cooperative sector rose from a mere Rs 94 lakhs in 1960 to nearly Rs 6 crores in 1967. As in the case of the State Bank of India, the subsidiary banks' performance with regard to small-scale industry too, was more impressive, advances to this sector rising from Rs 1.87 crores to Rs 15.7 crores, or to nearly 10 per cent of all advances, between 1960 and 1967.

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