
The Bank and Governments

The nature and scope of the regulatory functions discharged by central banks and their relations with other economic policy-making bodies, in particular the government, have been debated for the greater part of this century. The enduring interest in these subjects derives from the belief that the institutional organization of economic policy-making and the manner in which the several bodies entrusted with responsibilities in this sphere relate to one another exert a crucial influence both on the policy-making process and on the effectiveness and credibility of economic policies. Debates about central banking, both in India and elsewhere, have also been animated by political-economic considerations. These have, however, been relegated to the background in recent years by the popular distaste for inflation and the growing consensus over the intrinsic merits of central banking independence.

Central bank independence is usually understood to imply the freedom of the central bank to frame monetary policies. But there are no settled views about the institutional arrangements within which such freedom should be secured or exercised. Similarly, there is much more consensus now than in the past that monetary policy should aim at price stability, but little over the means of reaching this objective. The debate is thus by no means over.

This concluding chapter offers an interpretative account of the evolution of relations between the Reserve Bank and the governments in India during the years covered by this volume. Unlike a majority of central banks, the Reserve Bank of India undertakes a variety of 'developmental' functions. It remains debatable whether a wider set of responsibilities helps enhance the autonomy of a central bank in relation to the government and other institutions or limits

it, and it is not the object of this chapter to resolve the debate one way or the other. It is sufficient for the present to note that it is often not possible to separate the scope of a central bank's often conflicting responsibilities from any meaningful discussion of the degree of freedom it possesses, or its ability to exercise that freedom. Hence, while the narrative in this chapter will focus principally on the evolving relationship between the Bank and the central and state governments, the former's widening sphere of activity during these years is an important part of the context and background to it. However, we shall largely steer clear of a discussion of the merits or otherwise of the Reserve Bank of India undertaking a variety of regulatory and developmental roles, except to the extent that these might be said to have compromised the independent outlook of the Bank in relation to its principal objective—preserving monetary stability.

II

The most important aspect of its relations with the government generally concerns the central bank's role as the monetary policy authority. It is as the principal regulator of monetary and banking aggregates that the central bank influences macroeconomic variables in the economy. The government too, is not without influence over these aggregates through its public expenditure and financing decisions. The central bank's powers to moderate the latter's effects are limited. Nor can these powers always be exercised without distorting in some sense the allocation of financial resources in the economy. Besides, closely as the government and the central bank may attempt to coordinate policy, their views of policy and its objectives can often diverge. The resulting pluralism is not without its uses: it lends some richness to the economic policy discourse and may help modify the policy course in a timely manner and without recourse to excesses in either direction. At the same time, however, it portends a certain degree of friction, if not always of conflict, in relations between the two institutions.

Conventional wisdom suggests that governments, particularly in systems where the popular mandate to rule has to be renewed at regular intervals, tend to take a relatively short-term view of economic problems. Besides, in the division of labour that is generally thought to prevail in many parts of the world, governments are expected to concern themselves with domestic economic stability, which for the larger part of the last five decades has meant maintaining low levels of unemployment, while the central bank sees to the rate of inflation and to maintaining some notion of external stability. Neither view survives close scrutiny without damage. Central banks have not been

indifferent to short-term considerations especially given the close, lively, and everyday interest they take in the operations of the money market. Nor have they always been indifferent to problems such as unemployment or even to those of a deeper structural nature; while governments, especially in recent years, have themselves learnt to be more concerned than in the past about inflation. Furthermore, even today in a world used to floating exchange rates, few finance ministers can survive prolonged spells of external instability without damage to their political careers. The enduring faith in the division of labour referred to above rests not so much on empirical knowledge or presumptions about the natural dispositions of governments and central banks—which are not cast in stone—but to shared academic views about the relative efficacy of various policy tools in relation to the problems of unemployment, and inflation and external stability. Whatever its basis, however, it is useful whilst discussing the history of relations between the Reserve Bank of India and governments to keep this distinction in mind, since the former is entrusted by its statute with responsibility for ‘securing monetary stability in India’.

III

Until the 1920s, there were only about two dozen recognizable central banks all over the world. Until the first world war, central banks and treasuries of the countries of industrial Europe operated in a relatively simple environment. The two decades preceding the war were generally marked by price stability in these economies. Governments were expected to balance their budgets, there being no notion yet of an active fiscal policy, and this task was less difficult at this time than it was to prove later. Central banks, for their part, set their eyes firmly on the external account. Although price stability was not yet an explicit objective of policy, the commitment to fixed par values produced that outcome indirectly. Interest rate changes, as many contemporaries recognized, were not without their influence on economic activity at home. But with levels of unemployment generally low, rates were lowered or raised principally to repel or attract short-term inflows and reverse capital outflows. Interest rate movements in response to payments pressures did not always accord with the so-called ‘rules of the gold standard game’. The degree of central bank activism and of domestic resistance often varied, the greater volatility of the London discount rate, for instance, contrasting with the enviable stability of the Paris rate, since the authorities at the latter centre used a variety of ‘gold devices’ to stem outflows.

The extent of institutional interdependence between central banks under the pre-1914 gold standard is debatable. Keynes described the system as an

'international orchestra' conducted by the Bank of England, implying thereby that the other central banks responded more or less passively to signals emanating from London. But recent research suggests that central banks (or analogous contemporary institutions) were not really free to set interest rates, so great was the degree of convergence in the world economy at the time. While this was unambiguously the case for central banks (or analogous institutions) of small, open economies so long as their governments were committed to maintaining free trade and capital flows, doubts have been expressed even about the ability of the Bank of England to follow an 'independent' discount rate policy. If at all the Bank of England held the baton, this research suggests, it wobbled in its hands in response to the notes and cadences coming from the first violinists situated across the waters on either side of the British Isles.

The gold standard central banks may not have been independent of one another. But they were largely independent of their governments. Since interest changes took place principally in relation to external influences about which they understood relatively little, most governments were generally content to leave bank rate decisions to the central bank. According to a senior Treasury official who joined the Bank of England in 1927, 'a change in the bank rate was no more ... the business' of his former department before 1914 'than the colour which the Bank painted [on] its front door'. This was an exaggerated, and possibly interested view, and there is much evidence to the contrary. But few will dispute that gold standard arrangements and the priority given to free capital movements (or 'gold payments' in contemporary parlance) gave the central bank a relatively free hand in monetary management vis-a-vis the government.

The scope for independent monetary policies was greatly reduced in the interwar environment of high unemployment, particularly in the major European economies. Interest rate policy grew more contentious domestically even as higher interest rates were necessitated by the prevailing climate of international monetary instability marked by the collapse of the gold standard, and then by the laborious and ill-timed efforts to restore it. At the same time, the grip the gold standard, and in the British case the pre-war exchange rate, exercised over the imaginations of policy-makers in these countries was so complete that few among them explored alternative options until the 1930s. France was almost the sole exception as she floated the franc in the mid-1920s. Britain and several other countries had to undergo severe deflation before they could return durably to the gold standard at their chosen parities. But while remaining committed to a general policy of deflation, governments in these countries sought to regulate its intensity and speed with an eye

to the public mood. As Winston Churchill, the British Chancellor of the Exchequer in the mid-1920s, put it, the object of his policy, which in the event was not realized, was to see 'Finance ... less proud' and 'Industry ... more content'. Consequently, decision-making in regard to monetary policies, which had previously rested mainly with central banks, passed unambiguously into the hands of governments. The great depression, the collapse of gold standard arrangements, and the urgent need to boost recovery *underlined* this shift to the further disadvantage of central banks.

The economic role of governments expanded in the aftermath of the second world war. Even if this did not necessarily lead directly to central banks being relegated to the margins of policy-making, it nevertheless further diluted their role in the conduct of monetary policy. With the developed countries generally committed to full employment, their external transactions were regulated to varying extents, and conflicts between external and domestic balance considerations were resolved increasingly in the expansionary world economy of the 1950s and 1960s through greater policy coordination. Although the Basel club, which comprised some central bankers, played a useful role in ensuring international monetary stability under the Bretton Woods system, governments became more deeply involved than central banks in these coordination exercises. This situation changed but little following the collapse of fixed parities, the regime of floating rates actually giving governments of the developed countries a further degree of freedom which many freely abused. It is only since the middle of the 1980s, when something akin to a coordinated managed float regime was inaugurated in a climate of more liberalized capital flows, that a few central banks have begun to come rather more into their own. Since then the trend towards central bank autonomy has gained momentum from a variety of factors, including the move towards monetary union in Europe, the so-called globalization of many national economies, and not least, recent research findings about the impact on longer-term growth of high rates of inflation and of stop-go measures to regulate them. Even now, however, governments in several countries continue to retain an important say in matters that are more commonly regarded as falling within the purview of central banks.

To the extent it exists in any coherent form, the doctrine of central bank independence was formalized in the troubled 1920s. Although the Brussels and Genoa financial conferences and the League of Nations bestowed their legitimacy on the idea, the moving spirit behind it was clearly Montagu Norman, Governor of the Bank of England, who was ironically enough during these years presiding over an institution which was increasingly ceding its

autonomy, though not yet its judgement, to Whitehall. The propagation of the doctrine coincided with the spread of popular government in Europe and elsewhere, and one of its principal objects was to insulate monetary policies, particularly in the context of the restored gold exchange standard, from the pulls and pressures of domestic politics. Consequently, the creation of independent central banks became an important plank of the European financial stabilization programmes that Britain, in particular, underwrote or participated in during the decade.

Political considerations played the pivot in shaping the constitution of the Reserve Bank of India when it was founded in 1935. The political landscape of the period was dominated by the prospects for constitutional reform and, where the British financial stake in India was concerned, by the growing shadow of representative, if not popular, governments coming to power at the centre. Fearing the effects on 'currency and exchange' of entrusting these subjects to a minister answerable to an elected legislature, the colonial authorities preferred to set up, singularly in opposition to the dominant sentiment in India at the time, a privately owned and managed Reserve Bank as part of the new constitutional arrangements. But the colonial government in Delhi and London had little use for an independent Reserve Bank after it became clear that the Finance Department would remain, even in the reformed dispensation, in the hands of a non-elected European official responsible to the Viceroy rather than to the legislature, and that far from returning members disposed to side with the government uncritically, elections to the Central and Local Boards of the Reserve Bank had led to these bodies being dominated by 'nationalist' businessmen. As some recent research reveals, the measures the colonial government took thereafter to rein the Reserve Bank in and curb its capacity for independent action included getting rid of Osborne A. Smith, the first Governor of the Bank, and threats to supersede the Bank's Board should it recommend monetary and exchange rate policies unpalatable to the government or to the authorities in London. By the time the war ended, however, a privately owned central bank had become an anachronism. The Bank of England was taken into public ownership by the post-war Labour government in 1946, and the Reserve Bank of India too, was taken over by the Government of India about three years later.

IV

The post-independence government in India could not afford to remain indifferent to the challenge of rapid economic development. As its spheres of engagement with the economy widened, so did the Reserve Bank's, and the

latter was called upon increasingly to advise the government or take initiative on matters lying outside the traditional domain of central banking, such as the planning process, organization of agricultural credit, development of cooperative organizations, term financing of industry and financing of exports, the development of handloom and small industries, the administration of exchange control, and even the promotion of tourism. The logic underlying the Bank's vision of its wider responsibilities has been spelt out elsewhere. Let us merely point out here that the resulting widening of the Bank's sphere of activity greatly increased the range of its contacts with both the central and state governments. Although the Finance Ministry remained its most important link with the government, the Bank also worked with the Planning Commission, and the ministries of agriculture, cooperation, and industry and commerce.

Likewise, the Bank was called upon to conduct state governments' banking operations, make advances to them, deal with the problem of states' overdrafts, and also help them raise loans in the market. These functions, which in some respects were unique among central banks to the Reserve Bank of India, and its responsibilities in the sphere of rural credit which was properly a subject for the states, brought the institution into close contact with their governments. Relations with the latter were beset, moreover, by political considerations and the proclivity of central agencies such as the Planning Commission to step up states' investment outlays. Enforcing a measure of financial discipline on state governments was complicated by a variety of factors, and the Bank was consequently drawn once again to work closely with the Finance Ministry of the Government of India to tackle this problem. Generally too, for reasons discussed below, the widening of the Bank's ties with various departments of governments produced the paradoxical effect of reinforcing its ties with the Finance Ministry.

The Administrative Reforms Commission set up a working group to study the working of the Reserve Bank in 1969. Describing the Bank's 'promotional and developmental' responsibilities as a 'historical accident', the working group's report argued that these 'did not go well with its role as a Central Bank'.

If as a Central Bank the R[eserve] B[ank of] I[ndia] is to discharge its main functions of management of money, development and regulation of banking and credit policies, and administration of exchange control, it should not be bothered with ... developmental and promotional functions,

the working group recommended.

It is worth noting that even this body saw the 'development ... of banking' as a key responsibility of the Reserve Bank. Although some of its recommendations were carried out in subsequent years, the reform (if such it was) was piecemeal, and few contemporaries ventured even as far as the working group in delimiting the Bank's functions. Speaking in Parliament on the Banking Laws (Miscellaneous Provisions) Bill in December 1965, Minoor R. Masani drew the government's attention to the dangers for the quality of its 'supervision and leadership' of enlarging the Bank's responsibility for managing the operations of commercial banks. But his views had little impact at the time.

In July 1957, the Governor, H.V.R. Iengar, commissioned studies by the Bank's officials of relations between central banks and governments in other countries. Iengar's immediate object was to seek a review of the 1955 arrangement on ad hoc treasury bills, which was discussed at some length in chapter 2, and on which more is said below. Understandably, while the Bank's studies examined the nature of relations between central banks and governments in several countries, they focused on the former's role in financing governments' ways and means. A few weeks earlier at the end of May 1957, Finance Minister T.T. Krishnamachari had announced in Parliament his intention to divest the Bank of its role as the apex lending agency for cooperative credit institutions and land mortgage banks. This led to some discussion of the scope of the Bank's responsibilities outside the narrow field of monetary policy. But it is significant that though taking place at the same time and initiated within the Bank by the Governor himself, the two exercises did not intersect at any point.

In the mid-1950s, the Reserve Bank was disposed to acquire ownership of a few banks associated with the former princely states, which the All-India Rural Credit Survey recommended in 1954, should be taken over by the State. Though unusual, it was not unknown for a central bank to participate in commercial banking operations either directly or through one of its subsidiaries, and many banking authorities in fact recommended such a course for countries with poorly developed banking systems. Although the Hyderabad State Bank passed initially into the Reserve Bank's hands when it was nationalized in 1956, state-associated banks were in the end taken over and reconstituted as subsidiaries of the State Bank of India. The Bank became the majority owner of the State Bank when it was formed out of the Imperial Bank of India, but exercised little operational control over it.

Officials at Mint Road drew a line at exercising administrative control over the stock exchanges. In April 1957, TTK suggested to Iengar that the government should yield to the Bank the powers vested in it under the Securities Contracts (Regulation) Act, 1956 to manage these

institutions. This Act gave the government powers to recognize stock exchanges, make or approve rules, make or amend bye-laws, supersede their governing bodies, and suspend their business. The Bank was, in the Finance Minister's view, in the 'best possible position to exercise control' over stock exchanges because it was not subject to 'administrative and political pressures such as are daily sought to be exercised on [the] government'. Control over stock exchanges, TTK also appears to have felt, 'dovetailed' neatly into the 'area of general monetary control'.

The Bank acknowledged that since stock exchanges played a 'vital part' in providing the market for both government securities and stocks and shares, it was essential for it to have a 'close and intimate knowledge of their functioning'. It was therefore willing in principle to allow its officers to be nominated as directors of recognized stock exchanges, maintain close contact with the office set up by the government to administer the Securities Contracts Act, and give it every assistance. Iengar was also in favour of a 'convention' whereby the government was always guided by the Bank in its actions under the legislation, so that 'it would be the Bank which would be administering the Act and not [the] Government'. But it was not 'desirable' for the government to give up statutory responsibility for overseeing stock exchanges or place it on the Reserve Bank. Iengar's personal experience of the functioning of stock exchanges taught him that no matter how the authorities acted in a crisis, controversy was impossible to avoid; while the Bank's experience of the bullion exchange was that the position of its directors turned 'most unpleasant' whenever a controversy developed. The government, Iengar informed TTK in April 1957,

can never escape the odium of taking decisions and sticking by them. This is what Government have to do every day and, in a democratic set-up, they are well accustomed to being shot at by every group which is disgruntled. But I think it would be a mistake to bring the Reserve Bank into such fields of controversy. The Bank has a high reputation because it is known to be engaged, in an atmosphere of detachment, in carrying out the responsibilities laid on it by Statute. Once the Bank gets mixed up in the controversies of the stock exchanges—and controversies in these organizations are liable to be particularly heated—the reputation which the Bank has is liable to suffer

That, Iengar added, would not be 'in the national interest'.

It is somewhat ironic, against this background, that Iengar should have himself been in the eye of the storm raised by the Mundhra affair. The latter

is discussed in appendix D. But following the controversy, the Bank decided to review some of its wider commitments, including those it was willing to shoulder in April 1957, in order to 'minimize the scope for possible misunderstanding of its position in the interest of upholding the highest public confidence in the monetary management of the country'. This review, which resulted in a Central Board memorandum on the subject, concluded that the Bank's 'functions should not be so diffused as to jeopardize its ability to carry out its primary responsibility as the monetary authority of the country'. At the same time, the memorandum counselled against the Bank withdrawing into an 'ivory tower'. As Iengar later explained the purport of the Central Board's resolution to the government, while the Bank should continue as in the past to 'function on a liberal rather than a narrow interpretation of its ... responsibilities' and not shirk its duties towards agriculture and small industry, it should disengage itself from bodies such as stock exchanges and commodity exchanges. Nor, according to Iengar, should the Governor or Deputy Governor be associated with the proposed investment board of the Life Insurance Corporation.

The Mundhra affair merely made the Bank pause for breath and did not fundamentally alter the course of its subsequent development. As discussed in chapter 9, TTK did not carry out his threat of May 1957. Although it was, in C.D. Deshmukh's words, a 'last minute inspiration', the Reserve Bank of India Act, 1934 already envisaged an important role for the Bank in the sphere of rural credit which it began to discharge in earnest from 1950 and endeavoured to enlarge during the next decade and a half. Its expanding involvement during these years in promoting term-lending to industry and the financing of exports and small industries was largely an outgrowth of contemporary ideas about its role which already commanded wide acceptance and legitimacy, and which were currently in the process of being realized in the sphere of rural credit. As such, this role too was initiated and expanded with little debate or controversy.

After the second world war, the Bank began acquiring powers to regulate the working of commercial banks. The latter were understandably not enthusiastic about regulation, in particular the regime of detailed inspections prescribed by the Banking Companies Act, 1949 which had few parallels at the time. But in keeping with contemporary views about the role of central banks, the Reserve Bank was also entrusted with the task of overseeing the functioning of these institutions. While the Bank's powers of supervision over commercial banks were strengthened during the 1950s and 1960s, they were also expanded towards the middle of the latter decade to cover cooperative banks and the deposit activities of non-bank financial companies. Few were

disposed to question even at this time the advantages of extending the Bank's control to the latter set of institutions or indeed of those of giving it power to effectively regulate only a part of their activities. On the other hand, the rise in non-bank institutions' public deposits was a result of the growth of direct controls over banks' deposit and lending activities, and the latter could hardly have been sustained without some regulation over the former. The debates and disagreements that occurred over the Bank's role in relation to cooperative banks too, merely highlighted the constitutional and practical aspects of endowing a central institution with powers to regulate the functioning of institutions which were subject in other matters to the jurisdiction of their state governments.

The Bank's role in financing state governments evoked some discussion in 1950–51. The preference of the two Deputy Governors, N. Sundaresan and Ram Nath, was to steer clear of state government loans while continuing to manage the issues of states willing to entrust this responsibility to the Reserve Bank. But the Bank decided at the instance of the Governor, B. Rama Rau, to support these loans to a limited extent. The context for this decision was clearly political. Schemes were under way to promote a modicum of integration in the financial sphere of the states and regions of the country which were coming together in the political sphere. The extension of banking treasury and currency chest arrangements was considered an important aspect of the process of financial integration, and the Reserve Bank's role in this regard—in particular its appointment as banker to individual state governments—was therefore judged to be crucial. A limited contribution towards their loans was thus felt to be a small price to pay for earning the goodwill of state governments proposing to enter the market, and for encouraging others to appoint the Reserve Bank as their bankers. Hoping to further promote the same objective, the Bank also agreed in the early 1950s to increase its ways and means advances to state governments. Although the implications for monetary stability of the Bank helping to finance state governments directly were not lost on officials, the view at the highest level of the Bank focused on the overwhelming political and economic advantages of promoting the financial integration of the Union. Fears that the price paid for financial integration might endanger monetary stability surfaced in the mid-1950s, as state governments ran up substantial overdrafts. Yet it was not until a decade later that in desperation, the Bank considered relinquishing its role as bankers to state governments which were 'chronically' overdrawn. Not only was this idea not implemented, neither the Bank nor the central government could thereafter summon the will to adopt the less radical step of stopping payments of state governments having large and persistent overdrafts.

It would be fair to argue therefore that, except in the context of the financing of state governments' deficits and to a lesser degree in the wake of the Mundhra affair, contemporaries did not generally perceive the likelihood of the Bank's other roles eroding or weakening its commitment to monetary stability. If anything, as became clear when Krishnamachari initiated his manoeuvres in the summer of 1957 to divest the Bank of its responsibilities in the sphere of rural credit, its commitment to monetary stability became a further justification in the Bank's own eyes for undertaking promotional and developmental responsibilities, since the central bank alone could discharge the latter without prejudice to the former. On the other hand, the fear in the Planning Commission and the agriculture ministry was precisely that the Bank would subordinate its rural lending activities to conservative monetary policy considerations or to those of institutional stability. Hence these departments sought to erect lines of credit and rules of financing that did not involve the Bank directly, and which appeared to it to endanger the integrity of the cooperative movement and carry, more widely, the potential to endanger the stability of the country's financial system.

The Bank may have been willing, in the last resort, to forsake its developmental responsibilities and nail its colours solely to the mast of monetary stability. But Mint Road's own preference, both in this instance and subsequently, was to defend its claim to the former. There was considerable justification for doing so since, though as yet unstated, the Bank tended to view these responsibilities as part of the 'institutional dimension' of its monetary policies. Besides, the Reserve Bank was better equipped than other agencies during these years to promote the reach and development of the country's financial system. However, in making this choice, the Bank was drawn ineluctably into expanding the size and scope of its developmental responsibilities. Widening its areas of activity and influence never became an end in itself during our years. Nevertheless, it also remains moot how far officials in the 1960s continued to view the Bank's less traditional pursuits in the manner their predecessors had done a decade earlier, as part of an effort to moderate populism rather than bow and bend to its every whim. Equally perhaps, on the other hand, the Bank had left itself few options on this score. Having ceded to the Government of India in the mid-1950s the power to draw on its credit virtually without limit, there was little the Reserve Bank could do to rein in a government disposed to adopt populist measures, except through greater institutional engagement with its different agencies. Not surprisingly, while these engagements may have increased the Bank's influence, they did so at the cost of its institutional autonomy.

Once the Bank began to shoulder and finance wider developmental responsibilities, its ability thereafter to reconcile them with the demands of monetary stability turned increasingly on the alliances it built within the government machinery. Paradoxical as it may seem to those disposed to locate the conflict between the central bank and the government in the narrow domain populated by monetary and fiscal policies and their respective objectives and institutions, the Finance Ministry emerged as the Bank's natural ally in the interdepartmental manoeuvring into which the latter was drawn during these years. While its close relations with the Finance Ministry enhanced the effectiveness of the Bank's intervention on a number of matters having important financial or monetary implications, particularly when these were handled primarily by other departments, they perhaps lulled the Bank into a sense of complacency vis-a-vis the Finance Ministry itself, and weakened its hand in dealings with that institution.

Thus, already by the mid-fifties, an unwary Bank appears to have perceived a closer consolidation between its views and those of the Finance Ministry than was warranted by circumstances or justified by experience. The best example of this is its almost casual acceptance of North Block's suggestion to keep the government in funds by crediting its account, whenever balances fell below Rs 50 crores at the end of each week, with money created against the issue of ad hoc treasury bills. Let alone a careful consideration of its likely consequences, no need was felt at the time even to explain or justify an arrangement which was viewed purely as an accounting convenience. No thought was given until over two years later to the possibility that the central government might be tempted to abuse the facility. Nor were other aspects of the arrangement—such as its impact on the Finance Ministry's ability to restrain the spending departments or that of the Bank to check state governments' overdrafts—considered at all at the time. So much so, in 1955 the Deputy Governor, K.G. Ambegaokar, made bold to counsel the central government against floating a second tranche of its loans on the ground that the government could place itself in funds more cheaply by creating ad hoc treasury bills! The 1955 arrangement also had the effect in due course of encouraging the Bank to increase its subscriptions to central government loans. As matters turned out, easy recourse to central bank credit not only eroded fiscal prudence at the centre, but more relevantly for our period, it also helped state governments to run overdrafts since a substantial part of these was subsequently taken over by the centre against fresh loans from the Reserve Bank. It is also far from clear that by agreeing to expand credit to the government, the Bank actually performed a service to the Finance Ministry. A less permissive regime may have strengthened

this department's civil servants, if not necessarily their political masters, in negotiations with state governments and the spending departments of the central government. As it happened, with this single indiscretion the Reserve Bank surrendered to the government a vital element of monetary control. The liberal availability of central bank credit greatly strengthened the Finance Ministry in relation to the Bank, and although the erosion of the latter's standing vis-a-vis the former may not have been palpable until nearly two decades later, its origins may be traced, at least in part, to the arrangement of 1955.

V

Since passing into public ownership in 1949, the Reserve Bank of India is an institution which is owned by the Government of India. Its capital is fully subscribed by the central government which also receives the surplus profits of the Bank. As discussed in another chapter, the Bank's discharge of governmental banking responsibilities is largely governed by sections 20, 21, and 21A of the Reserve Bank of India Act. The wider public responsibilities of the Bank are reflected generally in the provisions of section 17 of the Act which contains numerous subsections, clauses, and subclauses. Sections 7 to 13 of the Act deal with the management and the general superintendence of the Bank.

The overall superintendence and direction of the affairs of the Bank rest, under the Act, with the Central Board of Directors. The latter comprises the Governor and up to four Deputy Governors, all 'appointed by the Central Government'. The Directors of the Central Board are all nominees of the central government, one each from the four Local Boards of the Bank, and eleven other Directors of whom one, usually the Finance Secretary to the Government of India, is a non-voting government official. In addition, the central government also appoints five members to each of the four Local Boards of the Bank.

The central government's powers to nominate Directors had not always been so extensive. The Reserve Bank of India Act as passed in 1934 and worked until the Bank's nationalization in 1949 provided for Directors and members of Local Boards elected by shareholders. This arrangement gave way to nomination when the Bank passed into public ownership. The effects of this change were obscured for a number of years by the continuity of its composition, with Directors such as Purshotamdas Thakurdas, B.M. Birla, Shri Ram, and C.R. Srinivasan remaining on the Central Board for many years after the Bank's nationalization. Even

thereafter for the most part, Directors nominated by the central government brought an independent outlook to bear on the deliberations of the Board.

The central government also has the power to appoint or reappoint the Governor and Deputy Governors for terms of up to five years. Governors and Deputy Governors are not appointees of the Bank but of the Government of India, and officials of the Bank elevated to these executive positions resign their former appointments to join the service of the central government. The central government also has the power to 'remove from office' the Governor, the Deputy Governor, or any other Director or member of a Local Board. Finally, the government can, in the event of the Bank failing to carry out its obligations under the Reserve Bank of India Act, supersede the Central Board, and vest the general superintendence and direction of the Bank in any agency of its choice. While these provisions, other than those relating to the nomination of Central and Local Board members, have been in the statute book since the original Act was passed, section 7(1) of the Bank Act was amended at the time of nationalization in 1949 along the lines of section 4 of the Bank of England Act, to empower the central government to give 'from time to time ... such directions to the Bank as it may, after consultation with the Governor of the Bank, consider necessary in the public interest'. The Bank sought a more elaborate provision requiring the government to formally 'accept responsibility' for the action resulting from its directions, but yielded to the latter's preference for the English precedent.

Inevitably, in addition to these formal statutes and regulations, relations between the Bank and the government—in particular the Treasury–Bank relationship—are also subject to a number of institutional and interpersonal factors. No reckoning of the latter can afford to ignore the large number of career civil servants inducted into the Bank as Governors, Deputy Governors, and Executive Directors of the Bank.

The first Governor of the Bank—Osborne A. Smith—was a commercial banker who was hand-picked for the position by Montagu Norman. Osborne Smith's tenure was a short one, and his successor, James B. Taylor, was a member of the Indian Civil Service until he resigned from the cadre to become Osborne Smith's deputy. Taylor's precedent has not always been followed by other civil servants appointed to executive positions in the Bank, despite the Central Board's repeated efforts during the 1950s to underline this principle to the central government. Taylor was succeeded by C.D. Deshmukh who also belonged to the ICS. So indeed did three of the four Governors—B. Rama Rau, H.V.R. Iengar, and L.K. Jha—who held office during the years

covered by this volume.¹ Alone among the Governors of our period, P.C. Bhattacharyya (1962–67) did not belong to this exclusive club. But he too was a career civil servant belonging to the Indian Audit and Accounts Service.

In addition, the Bank saw a steady migration of civil servants from the government, either as Executive Directors or as Deputy Governors. B. Venkatappiah, ICS, who was earlier Finance Secretary in the Bombay government, entered the Bank as Executive Director and rose to become a Deputy Governor before taking over as Chairman of the State Bank of India in whose creation and transformation he had played a major role. K.G. Ambegaokar was Secretary for many years in the central government before he came to the Bank as Deputy Governor. Others who served in the Finance Ministry in senior positions before coming to the Bank as Deputy Governors or Executive Directors during the 1950s and 1960s included N. Sundaresan, M.V. Rangachari, R.K. Seshadri, J.J. Anjaria, B.N. Adarkar, and A. Baksi.² In addition, other civil servants such as M.R. Bhide moved from the Agriculture Ministry of the central government to join the Bank in senior executive positions. Indeed, of the thirteen Deputy Governors appointed during 1951–67, only five, J.V. Joshi (who held office for four months), Ram Nath, C.S. Divekar, B.K. Madan, and D.G. Karve, did not come from any wing of the government. Of these five, only the first four came from within the Bank, where the steady flow of government servants into senior positions was viewed with mixed feelings, the delay especially in Madan's well-deserved elevation to the post of Deputy Governor appearing to have caused some resentment. Karve was a distinguished academic and cooperator.

Despite the long tradition of appointing ICS officers in particular as Governors, the practice continued to raise eyebrows as late as 1967 when parliamentarians such as Madhu Limaye raised the issue with the government. However, civil servants need not necessarily submit the Bank to the tutelage of the Finance Ministry or more widely to that of the central government. N. Sundaresan, who was a Deputy Governor in the early 1950s, had earlier served in the Indian Audit and Accounts Service, but he reconstructed himself so comprehensively in the image of the orthodox central banker that one is easily liable to overlook his past. Besides, neither Rama Rau nor Iengar had served in the Finance Ministry.

¹ K.G. Ambegaokar, who was Governor for a few weeks between Rama Rau's exit and Iengar's coming to the Bank, also belonged to the Indian Civil Service. So did N.R. Pillai, who was appointed to succeed Rama Rau, but did not take up the office.

² Anjaria was formally an officer of the Bank on deputation to the Government of India. He however saw little active service at Mint Road before returning as Deputy Governor in 1967.

L.K. Jha was earlier in the Finance Ministry. He confessed in a newspaper interview in April 1984 to having held a 'basic reservation about conservative monetary policy'. Jha regarded 'development to be a more important goal of economic policy in ... India than [the] stability for which central banks normally strive'. 'Monetary constraints', he argued, produced 'stagnation, not stability', and this view determined his 'basic approach' as Governor of the Bank. Jha himself attributed his view to the 'Keynesian influence' (he read economics at Cambridge) and 'assignments ... in government'. But it is difficult to tell where the former's influence ended and the latter's began, or how far their 'assignments in government' predisposed officials in the Finance Ministry to take a particular corporate view of economic policy.

Jha did not hold office for very long where this volume of the Bank's history is concerned. Of the Governors who served a full term in office during our years, only Bhattacharyya had worked in the Finance Ministry before moving to head the State Bank of India where he succeeded Iengar upon the latter's elevation as Governor of the Bank. So that to the extent a common manning pool (this term is hardly inappropriate since no woman held office even as Executive Director during these years) may have assisted in this outcome, the close relations existing during our period between the Finance Ministry and the Bank were forged more at the level of Executive Directors and Deputy Governors than at the highest level.

Even in retrospect it is hard to determine the extent to which the presence of civil servants in senior positions compromised the independence of the Bank. Nor is it possible to separate their influence from that of the intellectual and ideological climate of the day. But it is entirely likely that with one or two exceptions, the induction of former civil servants directly at the top encouraged the Bank to venture into areas which more traditional central bankers with less public experience may have wished to steer clear of. That the Bank tended to take a narrower and more insular view of its responsibilities in the late 1940s than became its wont in the subsequent decades is undeniable. As late as 1951-52, the two Deputy Governors, Ram Nath and Sundaresan, took a dim view of diluting the Bank's core central banking functions.

Whether this insular outlook would have survived the climate and challenges of the 1950s regardless of who ran the Bank, is a question that can never be satisfactorily answered. But it is sobering to recall that the world over in the 1950s, central bank autonomy was thought to be a relic of the past. In an age dominated by government, many central banks were content to be relevant and grateful for influence. Lest we overburden the past with our present-day preoccupations, it is also worth remarking that the Reserve Bank of India's international stature appears at this time to have been considerable. It was

often invoked as a model for other central banks in the developing world, and at least until 1955, it possibly wielded a greater influence over the government than the central banks of several other countries including the Bank of England.

It was left to Rama Rau, who as well as being an experienced civil servant maintained close links with business and industry, to bring some fresh air into the corridors of the Bank in the early 1950s. With Venkatappiah's arrival at Mint Road soon afterwards, the whiff turned into a gust as he led the Bank, with not a little support from the Governor, into paths which no central bank had ventured into before. Rama Rau's later years in office were ones of relative quiet, or of consolidation if one is disposed to take a more generous view, and he was a tired man by the time T.T. Krishnamachari forced him out of office in January 1957.

Though a former civil servant, Iengar, who succeeded Rama Rau, was elevated as Governor after having successfully initiated the task of orienting the former Imperial Bank towards non-traditional banking goals. So that he came to the Bank with something of a crusader's spirit. The Bank steadily expanded its commitments and widened the scope of its engagement with a variety of agencies during the Iengar years. The latter part of Iengar's tenure was once again marked by a desire to consolidate rather than expand.

This continued to be a feature of Bhattacharyya's early months in office. Self-effacing by temperament but firm when it mattered, Bhattacharyya's tenure coincided with the pursuit of a more active monetary policy. He shared a good working relationship with the three Finance Ministers—Morarji Desai, T.T. Krishnamachari, and Sachindra Chaudhuri—who held office during these difficult years. Bhattacharyya's relations with TTK, in particular, were very close. He was at the State Bank during TTK's earlier stint as Finance Minister when the two men together weathered the Mundhra storm. Krishnamachari's return to the Finance Ministry in August 1963 accelerated the pace of institutional development with startling suddenness, and the Bank under Bhattacharyya's leadership effectively complemented TTK's initiative to set up institutions such as the IDBI and the Unit Trust.

Thanks to the complementary roles they played in guiding institutional and developmental initiatives and financing programmes to fruition during these years, the Bank and the Finance Ministry managed to establish a close working relationship. It is clear from the Bank's records that the Governor and the Deputy Governors regularly advised the government on a variety of issues, including some in which the Bank could have little interest in any capacity. The Bank also substituted for the government on more than one occasion. The Rural Credit Survey, whose Report became its gospel in this sphere for the next decade, was entrusted to the Bank because the government

preferred to have the subject studied first at a technical level and possibly wished to diminish public expectations about the likely scope of reform. For similar reasons, the Shroff Committee on financing the private sector was again constituted by the Bank rather than by the central government.

On the other hand, the Government of India failed even to consult the Bank, let alone give it a fair hearing, on some very fundamental issues with significant monetary policy implications. For example, the Bank's views were not sought either on the first plan or, more startlingly given its size and the financing problems involved, on the second plan until after these were finalized. The Finance Ministry too, according to T.T. Krishnamachari's letter to Jawaharlal Nehru written in the wake of the foreign exchange crisis of 1957-58, was kept in the dark about the financing aspects of the second plan.

VI

Under the Reserve Bank of India Act, the Bank is subject to the control of the central government. The government's control sat lightly upon the Bank in the early years of our period. So wide indeed was the latitude allowed to the Bank and the Governor at this time, that the financial press thought nothing of speculating about the prospects of the Finance Minister, C.D. Deshmukh, returning to Mint Road in 1954, or of the former Finance Minister, John Matthai (who was later appointed the first Chairman of the State Bank of India), becoming Governor when Rama Rau's term in office ended. But events in 1956-57 underlined with startling clarity that it was possible for a powerful Finance Minister to transform levers of influence that had largely lain dormant for many years into instruments with which to subordinate the will of the Bank to his own. These events culminated in Rama Rau's resignation as Governor directly as a result of disagreements with Finance Minister T.T. Krishnamachari, which erupted into barely concealed conflict late in 1956, and Prime Minister Jawaharlal Nehru's refusal to distance himself from TTK's efforts to undermine the independence of the Bank. The Rama Rau resignation episode was a defining moment in the Bank's history during our period. It also sheds light more widely on relations between governments and public institutions in India. Therefore, it is instructive to dwell upon this episode at some length.³

³ The papers bearing on this episode, including the letters exchanged between Jawaharlal Nehru and Rama Rau, are reproduced in the selected documents at the end of this book.

Differences between Rama Rau and Krishnamachari appear to have gone back a long way. While there is no dearth of speculation as to the origins of these differences, it is sufficient for the present to note that the new Finance Minister had for some years held an unflattering opinion of Rama Rau.

As a backbencher, the future Finance Minister campaigned for the nationalization of the Imperial Bank of India. Even as Minister for Industry and Commerce in the Union Cabinet, he took a close interest in the subject. Writing to the Finance Minister, C.D. Deshmukh, in September 1952 to press for greater control over the Imperial Bank, Krishnamachari confessed that he was 'prejudiced against Rama Rau and [had] criticized his appointment as Governor in the past'. Although his views of the man had 'undergone a change in his favour' subsequently, TTK maintained that Rama Rau was not a 'sound guide' on matters related to the Imperial Bank. Krishnamachari also appeared to imply in this letter that Rama Rau opposed taking the Imperial Bank into public ownership, among other reasons because an alleged 'stooge' whom Roderick Chisholm, the Managing Director of that institution, was 'grooming' as his successor was a close relative of the Governor. Rama Rau's path crossed Krishnamachari's at other times as well. For instance, in 1954 the Governor circulated a note arguing for a scheme of time-bound support for the handloom sector administered through institutional financing agencies to replace the existing cess fund scheme. Krishnamachari, who favoured the latter, took violent exception to this note, and in particular to its quoting—and purportedly misrepresenting—his remarks to the Cabinet on the issue.

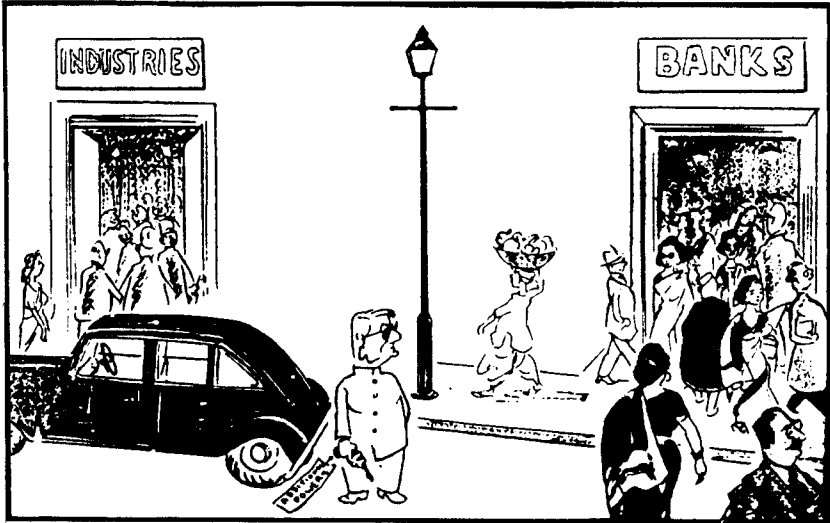
Relations between Deshmukh and Rama Rau were cordial to begin with and correct at all times. Though as Finance Minister, Deshmukh could sometimes be sensitive to criticism by the Reserve Bank, he was determined for the most part to respect the Bank's autonomy and stature and enjoyed the confidence of the Bank, and of Rama Rau in particular. Relations between Deshmukh and Rama Rau may have been strained towards the end of the former's term in office. Deshmukh, for example, was clearly puzzled by the intensity of Rama Rau's opposition to the takeover of all the so-called state-associated banks. For reasons that are not altogether clear but which may have had their origins in the internal politics of the Congress party and the government, Deshmukh (who in 1955–56 also yielded to pressures to nationalize life insurance business in India) was eager to implement the Rural Credit Survey's blueprint for these institutions. Rama Rau favoured nationalizing only three state banks in the first instance, and there is some evidence that Deshmukh perceived the Governor's attitude towards the issue as being obstructive rather than helpful. Rama Rau too, appears by this time to have tired of his prolonged stint as Governor. In office since 1949, it was

with some difficulty that he was persuaded by the Prime Minister and the Finance Minister, both of whom wanted him to see the Rural Credit Survey's recommendations through to fruition, to continue for two more years when his extended term expired in March 1955. It was probably clear to Rama Rau by now that there was little he could look forward to in public service, and he may have also seen the writing on the wall for the Bank's influence in the new policy dispensation which was beginning to coalesce around the Planning Commission at this time. Whatever their differences, however, Deshmukh and Rama Rau formed a close and cordial, if not always a cohesive team, with each person respecting the other and giving him and his institution adequate space and autonomy.

Deshmukh's resignation in July 1956 over the report of the States Reorganization Commission and Krishnamachari's appointment soon afterwards to the vacant Cabinet position could not have greatly increased Rama Rau's enthusiasm for his job. TTK too, for his part, appears to have done little to make the Governor feel at ease or to reassure him. On the contrary, according to Rama Rau's letters to Nehru and TTK, the latter behaved towards him with 'personal rudeness', used 'very rude language', passed 'rude remarks', and indulged in 'rude behaviour'. Rama Rau protested at this attitude 'more than once' and would have, but for the Prime Minister's intervention, handed in his papers earlier. Precisely when these instances of rude behaviour commenced is impossible to establish. But it is clear that within weeks of assuming office as Finance Minister in August 1956, Krishnamachari began making his differences with Rama Rau over the busy season credit policy public, even going to the extent of announcing, pointedly in the Governor's presence, a monetary policy stance which was at variance with that signalled or preferred by the Bank.

Relations between Rama Rau and the new Finance Minister were thus never cordial. But the provocation for the series of public and private incidents culminating in the Governor's resignation sprang from differences between the Bank and the Finance Minister over one of the supplementary taxation proposals the latter tabled in Parliament at the end of November 1956. The controversial proposal envisaged an increase in the stamp duty on bills from 2 annas per Rs 1,000, at which rate it had remained since 1940, to a maximum of 160 annas or Rs 10 per Rs 1,000, and immediately to 80 annas or Rs 5 per Rs 1,000. So steep an increase in the stamp duty had immediate implications for the viability of the Reserve Bank's bill market scheme.⁴

⁴ The bill market scheme is described in chapter 3.

The Next Hold-up

Mr. Krishnamachari has been speaking of further measures to raise funds for the Plan.

— *Shankar's Weekly*, 30 Dec. 1956

It is possible that soon after taking over as Finance Minister, Krishnamachari had decided to force a confrontation with Rama Rau. His decision to raise the stamp duty on bills is otherwise inexplicable. The stamp duty proposal may appear little different at first sight from an interest tax such as has traditionally divided governments and central banks. TTK believed in mobilizing larger tax resources in every possible way and was undoubtedly something of an innovator in the fiscal sphere. He also favoured levying an explicit interest tax in 1965 during his second stint as Finance Minister, but was dissuaded by Bhattacharyya from doing so. But the analogy between the stamp duty increase TTK effected and the interest tax is an inexact one. So wide was the range over which the Finance Minister sought powers to vary the stamp duty by executive order, that it had the potential to translate into a hike in the effective lending rate under the bill market scheme of one percentage point, or an implicit 'tax' on the interest paid on accommodation against bills of nearly 29 per cent at the prevailing Bank rate of 3.5 per cent. Even the duty TTK proposed immediately to levy—of half of one per cent—meant a 'tax' of about 14.5 per cent on the interest charged or paid by banks on advances involving bills, at a time when the minister himself was in favour of easing financial stringency. Besides, revenues from stamp duties were collected by the centre for distribution to the states and

though not trivial, the benefit to the latter's resources of the hike was unlikely to have been substantial. The Finance Minister refused to divulge to Parliament any estimate of additional revenue from the higher stamp duties on the plea that the latter were not intended to raise resources. But to judge from aggregate bill market drawings in 1956 of Rs 436 crores, it is unlikely that the total stamp duty collections on usance bills at the proposed new rate would have greatly exceeded Rs 2 crores.

Nor was Krishnamachari's defence of the hike in Parliament and elsewhere convincing. His argument that the move was intended to promote the use of bills is almost perverse. The Finance Minister also justified the increase as a credit control measure falling short of a generalized increase in the Bank rate which he preferred to avoid both to preserve easy money conditions in the market and to reduce the possibility of banks profiteering from it. Taken separately or together, the two explanations defy understanding. Aggregate bill market drawings by scheduled banks were nearly as large or larger than their drawings against other securities between 1955 and 1957. Consequently, a rise in the effective bill market rate would not have left banks' general lending rates unaffected. This method of raising lending rates, moreover, left greater discretion in the hands of banks than a public and transparent increase in the Bank rate. Finally, it is difficult satisfactorily to explain the speed with which differences between the Finance Ministry and the Bank over a monetary policy-related issue degenerated into a public war by the Finance Minister against the Reserve Bank and its Governor otherwise than as an effort to force the latter out of office.

If Krishnamachari wanted a confrontation with Rama Rau and the Reserve Bank, he could not have chosen a better issue from his own point of view. The Governor took a close—perhaps too close—interest and considerable pride in the working of the bill market scheme which he regarded as his principal achievement at the Bank. The bill market scheme had only recently freed itself from the crutches of stamp duty and interest rate subsidies. But TTK's latest proposal threatened to end it altogether, since the effective rate of borrowing under it would now exceed 4 per cent when most banks could continue to avail of accommodation against government securities at the prevailing Bank rate. Further, not only had the Bank not been consulted about this proposal—its views had merely been sought on whether the new rates should be forty times the prevailing rate or eighty—the Finance Minister added insult to injury by declaring in Parliament that the proposed hike was a 'fiscal measure with monetary intent'. Indeed, as a memorandum which Rama Rau submitted to the Central Board of the Bank in December 1956 pointed out, the Finance Minister's move now meant that there would be

two authorities who would operate the Bank rate—the Reserve Bank in the usual manner under Section 49 of the Act, and the Government by variation of the stamp duty by executive order of the Finance Ministry.

The ‘consequences of this dual control of the Bank rate’, Rama Rau added, ‘need hardly be emphasized’.

Krishnamachari’s proposal evoked opposition from other quarters as well. As described elsewhere, there was a clamour from banks and businesses for easier credit in the 1956–57 busy season and for more liberal access to the bill market scheme. Far from liberalizing credit or access to the scheme, the new measure would discourage the use of bills and force banks which had them to sell or borrow against government securities. As H.V.R. Iengar, who was at this time the Chairman of the State Bank, explained to Rama Rau early in December 1956 and to TTK a month later, his institution could no longer borrow under the bill market scheme except at a loss to itself so long as it continued to peg its lending rate at four per cent.

Remonstrations to the Finance Minister against his stamp duty proposals were unavailing, even perhaps counter-productive. As protests multiplied and banks reduced their bill market limits with the Reserve Bank, Krishnamachari began to nurture dark suspicions that they were ‘boycotting’ bills deliberately to create a credit squeeze and force him into a retreat. Suspecting the State Bank’s role in this alleged campaign, he made a series of public comments against banks in general and the State Bank in particular.

Rama Rau’s efforts to persuade the Finance Minister to moderate his stance were—in the background of worsening relations between the two men—perhaps doomed to failure. Even if the minister did not initiate the stamp duty hike in order to force a confrontation with Rama Rau, the latter’s protests appear to have strengthened his resolve to elevate the issue to one on whose resolution would turn the future of the central government’s relations with the Reserve Bank. TTK, according to the Governor, responded with ‘personal discourtesy’ to his objections to the higher duties. This may have been an understatement. According to B.K. Nehru’s recollection of the episode, the Reserve Bank’s case went up to the Prime Minister who put it to the Cabinet at an informal meeting to which Rama Rau was also invited.⁵ TTK, according to this account, was angry with the Governor for forgetting that ‘he had been asked to attend ... only to answer specific questions’, and for his ‘temerity’ in speaking

⁵ B.K. Nehru, *Nice Guys Finish Second: Memoirs* (New Delhi, 1997), pp. 272-73.

at the meeting in defence of the Bank's views. When next they met, according to B.K. Nehru, the Finance Minister 'let fly in no uncertain terms and in the loudest of voices, at the Governor of the Reserve Bank of India'.

Not yet the chronicler he later became, B.K. Nehru retreated from the scene of this 'undignified brawl between the two highest ranking officials of the financial establishment'. There was, it appears, not much of a brawl since even according to Nehru's account, 'Rama Rau, the mildest of men, did not know how to handle ... [TTK's] unmeasured onslaught'. Unfortunately, though perhaps in the circumstances not surprisingly, the Governor too has left no complete account of this incident. But according to the few references Rama Rau made to this or to another meeting with the Finance Minister, the latter spoke derogatorily to him of the Reserve Bank as a 'department' or 'section' of the Finance Ministry.

Rama Rau's immediate reaction to these provocations was to resign his position as Governor. While he himself felt TTK's attitude made it impossible for him to continue in office, his trusted advisers were also of the view that the Governor could not stay on 'with any self-respect' or without further damaging the 'status' of the Bank or the 'status and dignity' of his office. But following long meetings with Jawaharlal Nehru and the Home Minister, Gobind Ballabh Pant, Rama Rau decided to hold his hand.

Matters did not, however, end there. Under the Reserve Bank Act, the general superintendence and direction of the affairs of the Bank are vested in the Central Board. Feeling it his 'statutory duty' to take the Board into confidence about the implications of TTK's proposal and the manner in which the decision to increase the stamp duty was taken, Rama Rau convened a special meeting of the Central Board on 12 December 1956 at which he circulated a memorandum entitled 'Implications of certain provisions of the Finance Bill, 1956'.

This memorandum too is reproduced at the end of this volume along with other papers bearing on this episode. Briefly, after explaining the Finance Minister's proposal, it pointed out that the decision was taken without consultation with the Governor or the Board 'on whom rests the statutory responsibility for altering the Bank rate'.

The decision of the Government was announced to the Governor and senior officers of the Bank six days before the introduction of the Bill, but it was made quite clear that it was a definite decision of Government on which the views of the Bank were not invited. The Bank's opinion was asked for only on the question of whether the immediate increase be Rs 5 per Rs 1,000 or Rs 10 per Rs 1,000.

The Governor then went on to describe his efforts to represent the Bank's view to the Finance Minister.

A few days after the introduction of the Bill, I attempted to discuss the implications of this measure with the Finance Minister, but he stated that he took full responsibility for the Government decision, that the Bank was a 'section' of the Finance Ministry of the Government of India and that we would have to accept the decision whether we liked it or not.

The memorandum also discussed at some length the implications of Krishnamachari's proposal for the Bank's independence. The latter had until then been preserved in India as in most other democratic countries, and although the government had powers under section 7 of the Bank Act to give 'directions ... after consultation with the Governor of the Bank ... in the public interest', no occasion had arisen since its nationalization in 1949 to necessitate the use of these powers. While the Bank and the Government of India had cooperated closely and 'harmoniously' during this entire period, Rama Rau pointed out, treating the Bank 'as a department of the Government of India' portended grave 'consequences' for its ability to exercise statutory responsibility for 'monetary policies and other matters'. After drawing attention to the dangers of 'dual control' over the Bank rate and of the increase in the cost of credit to industry emanating directly from the Finance Minister's proposal, the Governor moved the Central Board to 'explain to the Government the full implications of this proposal and request them to reconsider it'.

Thereupon the Central Board resolved that while the stamp duty might be regarded as a 'fiscal matter' its steep increase had, by the Finance Minister's own admission, 'monetary implications' which could not be 'ignored'. The stamp duty 'added substantially to the Bank Rate' which it was the 'statutory responsibility of the Reserve Bank to fix every week'. The latter's view, the Central Board felt, 'should, therefore, have been sought on the subject'. The resolution ended with a 'request' to the government 'to consult the Reserve Bank in advance on all matters which significantly affect[ed] ... monetary structure and policy'.

Helped along not a little by an angry Finance Minister, matters spun out of control from this point onwards. Jawaharlal Nehru received a copy of the memorandum from the Ministry and immediately wrote to Rama Rau expressing his 'great surprise' at its contents. The memorandum, Nehru told Rama Rau, was 'improper' and 'agitational'. 'To address your Directors in this way seems to me extraordinary.' The Prime Minister also took the Governor to task for disclosing in the memorandum details of a 'private talk'

between him and the Finance Minister. He also suggested, curiously and without offering any elaboration, that the Reserve Bank's policies were 'contrary to those of the Central Government'.

The Central Government ... is directing its policy to attain certain objectives laid down in the Five Year Plan. It would be completely absurd if the Reserve Bank followed a different policy because it did not agree with those objectives or with the methods of achieving them.

In a letter he wrote to the well-known cooperator, Vaikunth Lal Mehta, a fortnight later, Nehru acknowledged that the government may have handled the matter badly and that the Governor of the Reserve Bank should have been consulted before the Cabinet decided to raise the stamp duty. But to Rama Rau himself, Nehru yielded little ground.

You have laid stress on the autonomy of the Reserve Bank. Certainly it is autonomous, but it is also subject to the Central Government's directions. The question of fixing the bank rate is a matter for the Reserve Bank to consider. The stamp duty proposed by the Central Government is not the same thing as varying the bank rate, although it has certain effects upon it. That decision in regard to [the] stamp duty was taken by the Cabinet after full consideration and I cannot accept any plea that the Cabinet should not do so until the Reserve Bank approved.

While it was 'certainly desirable' to seek the Bank's views, Nehru pointed out in defence of his Finance Minister that the latter had 'mentioned' the matter to Rama Rau 'six days before the Bill was introduced in Parliament'. Finally, the Prime Minister expressed surprise that the Reserve Bank should 'encourage and indirectly participate' in the criticism of the government by 'some sections of the business community' who disapproved of the government's 'basic policies'. The Bank's memorandum, Nehru also told Mehta, was 'practically an indictment of Government's policy'

Jawaharlal Nehru's letter caught Rama Rau by surprise. Their meeting the previous week may have encouraged the Governor to conclude that the Prime Minister was not insensitive to the Bank's wider concerns. But his latest letter conveyed the opposite. With Nehru having, however, left on a prolonged overseas tour shortly afterwards, there was little Rama Rau could do immediately. Possibly emboldened by the Prime Minister's letter, which he may have even had a hand in writing since Nehru sometimes relied on his ministers to prepare preliminary draft letters for him in their areas of

competence, Krishnamachari chose to utilize Nehru's absence to intensify pressure on the Bank. He had accused the Reserve Bank in Parliament earlier of being 'reserved' and of being incapable of 'doing any thinking'. In a series of comments he made to the press in the south and in his address to the South India Chamber of Commerce in Madras towards the close of 1956, the Finance Minister carried his attacks on Indian banks and on the Reserve Bank, in particular, to the public. He once again accused the latter of betraying a 'clerical mentality' and suggested that it believed in a policy of 'stay put' and had turned moribund. He also attacked the State Bank and other banks in similar vein.

Krishnamachari's attacks on the State Bank invited a spirited reply from the head of that institution. Its Chairman, Iengar, wrote to the Finance Minister to convey his 'distress' at the latter preferring to carry out a 'public attack' on the bank to a 'private talk' with him. Since such attacks reflected adversely on his leadership of the State Bank and had created uncertainty in the minds of his staff, Iengar asked to know whether the government wished to replace him. As Vice-Chairman of the State Bank and the person instrumental in bringing Iengar to head it, V.L. Mehta 'deplored' TTK's criticism of the State Bank and the Reserve Bank and offered in a letter to Nehru to relinquish his position in the former since he had not 'outgrown' either the 'clerical mentality or an Imperialist outlook'. While TTK had little trouble in placating Iengar, Nehru managed to pacify Mehta. It should however be mentioned for the sake of completeness that TTK was less forgiving of Mehta than Nehru, as he pointedly ignored the cooperator's advice about Iengar's successor at the State Bank.

Matters with Rama Rau had gone too far, however, and there was now no pulling back. Rama Rau responded to Nehru's letter with a long, eleven-page reply in which he confessed to being 'puzzled' and 'pained' by its tone and contents. Explaining his conduct and rejecting the criticism that he had adopted an 'agitational approach', Rama Rau contrasted his own discretion with the Finance Minister's tendency to make public and private attacks on the Bank. Rama Rau pointed out that he had no choice but to take the Central Board into confidence about Krishnamachari's intentions, since his refusal to consult the Bank about a decision which directly affected its statutory responsibilities was not 'due to ... oversight but to his definite view that as a mere department of the Finance Ministry, the Reserve Bank was not entitled to be consulted'. The 'definite intention' of the Reserve Bank of India Act was to set up an autonomous body and this intention was restated in 1949 when the Bank was nationalized, but the Finance Minister seemed to have other ideas. The Governor also objected to the Prime Minister's suggestion that the Bank challenged the government's wider policies. Rejecting such allegations and defending the Bank's record both with respect to monetary stability and in

supporting the government's policies for development, Rama Rau however informed Nehru that he could no longer continue in office because of the Finance Minister's attitude, and sought his permission to resign.

I assured you that I would not go against your wishes in regard to my resignation, but the public attacks of the Finance Minister on the Reserve Bank have created a new situation in which it will be absolutely impossible for me to continue in office. I hope you will appreciate my position and allow me to submit my formal resignation

Nehru was perhaps reconciled to losing Rama Rau, since he refused even now to yield any ground. Maintaining that the Central Board memorandum was 'improperly worded', he advised Rama Rau to view the Finance Minister's remarks about the Bank in a 'larger context'. The Bank, he said, was

obviously ... a part of the various activities of the Government. Obviously also it has a high status and responsibility. It has to advise the Government, but it has also to keep in line with Government.

In the letter he wrote to Mehta around the same time, Nehru also defended Krishnamachari's public outbursts against the Bank as being in the nature of 'general remarks' made in reaction to the Board memorandum.

Rama Rau vacated office on 14 January 1957. In his resignation letter written a week earlier to the Finance Minister, Rama Rau protested TTK's 'unwarranted and insulting remarks' against the Reserve Bank. Such attacks by a Finance Minister on a central bank were 'absolutely unprecedented'. They were also unfair, given the Bank's substantial record of achievements. Recalling the cordial relations the Bank had enjoyed in the past with the Finance Ministry, Rama Rau stressed that it had always striven to maintain its independence even while cooperating fully with the government in implementing national policies. The Governor also pointed out to Krishnamachari that he had

more than once protested against your personal rudeness in the past, but I was prevailed upon to overlook it. Since, however, you have now thought it necessary to make public attacks on the Reserve Bank, it is not possible for any self-respecting Governor to offer that wholehearted cooperation with the Finance Ministry, which is absolutely necessary in the interests of the country during the critical times ahead of us.

In a letter he wrote to Nehru at the same time, Rama Rau conveyed his decision not to 'issue any public statement' even after relinquishing office unless there was some 'fresh provocation', since 'any public controversy between the Reserve Bank and the Finance Ministry might have repercussions in this country and abroad'. The events leading to Rama Rau's departure from office also provoked Purshotamdas Thakurdas, who had served without interruption as Director since the Bank's founding in 1935, to sever his connection with the Central Board when his current term expired.

The happenings in the last couple of weeks in the relation between the Board of the Reserve Bank and the Central Finance Ministry are so extraordinary, one-sided and unprovoked that I feel that it is not to the interest of the country that any non-official should avoidably keep up his connection with the Reserve Bank,

Thakurdas wrote to Rama Rau whilst requesting him to 'do the needful' to ensure that he was not 'renominate' to the Board.

Rama Rau's resignation brought the curtain down in more ways than one on an important period of the Bank's history. His was the longest spell in office for any Governor of the Reserve Bank since its founding, and Rama Rau's years as Governor coincided with an eventful period in the country's financial history. The Bank also saw a steady rise in its public and policy profile during these years, which Rama Rau was keen to promote and protect. It was in some ways entirely appropriate that Rama Rau should have sacrificed his office in defence of the Bank's independence since he, along with Deshmukh, had played a major role in safeguarding this feature of the institution's functioning since its nationalization in 1949.

Until 1956, according to B.K. Nehru, the Reserve Bank was 'one of the few financial institutions that had still retained some measure of autonomy'. But from the day the Prime Minister chose to back TTK against the Bank, it lost 'even such autonomy as it till then exercised and started becoming another subordinate office of the Government of India, taking orders even more than before from the Ministry of Finance'.⁶ The latter view may be somewhat exaggerated even where the remaining years of our own period are concerned. The Bank's freedom of policy, or its absence, depended on a number of other factors too, during these years, and as we point out

⁶ Nehru, *Nice Guys Finish Second*, p. 272.

below, it was restored briefly in the mid-1960s as the economy came face to face with a daunting set of domestic and external challenges. Nevertheless, Rama Rau's resignation proved that no Governor could hope any longer to defend the autonomy of the Bank by unfurling banners announcing its independence. 'Independence of the central bank' as the Bank, responding in August 1958 to the Radcliffe Committee questionnaire, acknowledged in words that evoked Nehru's remarks to Rama Rau on the subject, did not 'in any case mean independence of Government, but independence within the structure of Government'. Differences with the government would persist and these would have to be resolved continuously, but the business of protecting the Bank's independence would henceforth have to be carried out privately and without a great deal of fuss. The consequent lack of transparency provided a further source of power to the central government vis-a-vis the Bank and portended serious consequences for the latter's ability to hold its own in future conflicts with the former. As matters turned out, while the Bank and the government continued to differ over a number of matters, including those relating to monetary policy, relations between the two did not plummet again to quite the same levels during the remainder of the period covered by this volume; nor, whatever the immediate consequences of the 1956-57 conflict, were the Bank's status and standing challenged in the same direct or overt way.

A few months after Rama Rau's resignation, Krishnamachari, in a move which revealed the extraordinary imagination and talents of the man, favoured strengthening the Bank's ability to conduct an independent monetary policy by divesting it of responsibilities in the sphere of rural credit. Krishnamachari's move was regarded at the time as another attempt to cut the Bank down to size. That it almost certainly was. But thanks to the misgivings with which his suggestions were often viewed, few within the Bank or the government paid any attention at the time to the very real conflict, which was in fact already becoming apparent, between the Bank's monetary policy goals and its wider commitments. But by the time he returned to head the Finance Ministry once more in 1963, TTK himself began identifying the Bank's independence with 'bigness' and the diversity of its responsibilities. Speaking in April 1964 on the debate over the bill to promote the Industrial Development Bank of India as a subsidiary of the Reserve Bank, Krishnamachari defended the Bank against left-wing critics demanding dissociation of the proposed institution from the central bank. The Reserve Bank, he told the Lok Sabha, with uncharacteristic generosity and possibly unconscious irony,

is in the picture for everything today, and I am very happy that successive Governors of the Reserve Bank have been able to shoulder this increasing responsibility that is being cast on them, are ... able to take an independent view and not completely subordinate their views to those of the party in power including the Minister. I have been very grateful during my two spells as Finance Minister for the independence shown by the Reserve Bank, and I want it to have that independence.

VII

H.V.R. Iengar, who succeeded Rama Rau as Governor, was Krishnamachari's personal choice for the position. In Iengar's favour was the fact that he had worked closely with the Finance Minister when the latter was in Commerce and Industry. The Finance Minister's capacity for 'inspiration, grasp, and drive' was believed to have the effect of producing in his officials a 'blind sense of loyalty'. Whether blind or not, Krishnamachari did not suspect Iengar's 'loyalty'. There was an impression afoot when his name was put forward, that though 'not a creature of Krishnamachari' it would be 'expecting a lot to think he would take an independent line at the Reserve Bank'. Iengar was familiar too with TTK's foibles and susceptibilities, and not entirely averse to indulging them. At the State Bank, for example, he was quick to investigate Krishnamachari's complaints about his institution denying accommodation to a south Indian company specializing in the hire-financing of trucks. However, soon after taking over as Governor, Iengar displayed considerable firmness in rejecting TTK's insinuation that the Bank's inspectors had acted unfairly in pulling up a south Indian bank for having made advances to a prominent newspaper group against the pledge of its immovable property. TTK also urged Iengar in June 1957 not to 'leave ... out' of bipartite consultations, the 'small Union affiliated to the INTUC in Delhi', only to be told in rather blunt terms of the Governor's own preference to 'leave matters as they are' Industrial relations at the Bank had been a 'little delicate' of late, and calling an unrepresentative union for talks might 'seriously disturb ... [the Bank's] relations with the bulk of ... [its] employees'. Whatever the outcome of TTK's intervention in these two instances, it is worth noting that he ventured his views to Iengar on relatively routine aspects of the Bank's functioning in a manner he may not have done with his predecessor.

Iengar was, by every account, a man of enormous charm and intelligence who brought a keen intellect and abundant energy to bear on his endeavours.

A good listener, he was affable, accessible, and encouraged debate within the organization. Iengar was also effective and vigorous as Governor. Yet it is impossible not to detect a certain change in the tone of the Bank's relationship with the government after he took over as Governor. In the speech he made to the annual general meeting of the Indian Banks' Association in March 1958, its chairman, C.H. Bhabha, spoke of the 'impression ... prevailing ... despite all official and Ministerial assurances' to the contrary of a 'certain amount of subservience of the Reserve Bank to the Finance Ministry of the Government of India'. Declaring that all knowledgeable people 'longed' for this 'key institution' to maintain a 'sturdy independence', Bhabha called for changes in the way the Bank's Central Board was constituted and a 're-enunciation of its autonomy'. He also proposed that the Bank should revive the tradition of 'effectual and highly critical review of economic conditions' and policies for which it was known before it became a 'State-owned organization'.

While Bhabha's call for 'sturdy independence' would no doubt have touched a chord, few even within the Bank would have sought it in order to make a 'highly critical review' of the government's policies. The Bank's views about central bank independence conveyed to the Radcliffe Committee and quoted above may have evoked Nehru's remarks, but did not for that reason fail to reflect contemporary sentiments at Mint Road. The means Iengar adopted to enhance the Bank's effectiveness were in the ultimate analysis derived from such sentiments. More dynamic and energetic than Rama Rau was in his later years in office and keener than him to mark a presence on a wider stage—Iengar had felt his 'horizon [was] ... somewhat restricted' in the State Bank—he stayed in regular contact not only with the Finance Minister, but also with other members of the Union Cabinet and the Prime Minister. Iengar's excellent interpersonal relations with ministers and officials were to prove useful to the Bank on more than one occasion. But it will remain moot whether in trying thus to break the Bank's seeming aloofness, he may not have unwittingly helped weaken its institutional autonomy, especially since his initiatives to widen the Bank's points of contact coincided with the growing disposition of the country's political class to assert itself in relation to its public institutions.

On the other hand, institutional autonomy might often be a euphemism for irrelevance, and a major concern of Iengar's was to transform the Bank into an institution which strove continually to be relevant to the economic challenges facing the country. Rama Rau had left the Bank suspended midway between the lofty heights of traditional central banking and the noisy parlours in which political and economic decisions were increasingly being made in contemporary India. At the moment of his exit, Rama Rau may even have wished to reverse the descent he and Deshmukh before him had commenced. Iengar, in contrast,

appears to have judged that the additional influence and leverage the Bank gained thereby justified its descent into the real arenas of economic decision-making.

Besides having to reckon with a more assertive political class, in other respects too, the circumstances in which Iengar took office were less propitious for the Bank's independence, if not its influence, than those which had attended the larger part of his predecessor's term. In 1949 when Rama Rau became Governor, the Bank held a virtual monopoly of economic and technical expertise anywhere in the government or outside it. The Bank alone at this time could boast a full-fledged economic analysis and research department in India. Although departments of government such as commerce and industry and finance had their own economic advisers even in the 1940s, the latter were either seconded from the Bank or worked closely with it. The government drew frequently upon the Bank's research expertise, even if it did not always accept the views and policy advice Mint Road pressed upon it, so that the latter, to use TTK's expression, was 'in the picture' on most major economic policy decisions of the period.

By the time Iengar became Governor, however, the analysis and policy landscape had been greatly transformed. Although according to the Bank's replies to the Radcliffe Committee questionnaire, its 'lead ... in relation to [the] Government in the systematic study of economic questions ... [remained] a factor of some advantage to the Bank', and its economists continued to produce pioneering work in such fields as savings, income distribution, and poverty, the Planning Commission set up in 1950 had meanwhile grown enormously in stature and influence. Its Perspective Planning Division and the body of researchers P.C. Mahalanobis assembled at the Commission and at the Indian Statistical Institute were beginning at this time to emerge into their own. Not only was this 'think-tank' closer to the corridors of economic and political decision-making in Delhi, the gospel of planned development brooked no rivals in the hearing and adherence it commanded from a political class led by the Prime Minister himself. Apart from the Planning Commission, ministries such as those of agriculture, community development, and cooperation too had now a body of specialized expertise differing in emphasis, if not in substance, from that available with the Bank. These ministries also tended often to make common cause with the Planning Commission against the Bank and the Finance Ministry, and at least during the early years of Iengar's stewardship of the Bank, the Planning Commission-led alliance appears to have had the ears of key decision-makers in Delhi, including the Prime Minister.

The Reserve Bank, it must be said, also underwent an intellectual conversion

during these years which lasted for some decades thereafter. This conversion distanced the Bank from the staple discourse of traditional central bankers, and steered its perspective closer to that of governmental bodies in Delhi. Signs of the new perspective were already evident during Rama Rau's final years in office. Consider, for example, his spirited defence of the policy of deficit financing in the speech he made to the Fund-[World]Bank meeting in September 1955, extracts from which are reproduced below. Although the Bank's faith in the policy of deficit financing and in the government's ability to conduct it successfully weakened in the late fifties, its departure in other respects from the traditional canons of central banking intensified. Thus the Bank began moving during these years towards a 'structuralist' understanding of the relationship between money supply and inflation. The 'structuralist' grip over the Bank's thinking withstood the inflation of the 1960s and the vicissitudes of the next decade.

It may be argued, with the benefit of hindsight, that the Bank would have been better off in the longer run had it chosen to offer to the government a brand of economic advice which was distinct from that available, say, from the Planning Commission. Contemporaries would probably have laughed such suggestions away. Not only did the Bank not have an 'objective function' distinct from that of the government, the remorselessly Darwinian and modernist intellectual climate of the day also meant that few economists regarded monetarist ideas and the classical axioms upon which they were based as anything other than the relics of a disgraced past.

Keynes's was the dominant economic influence at the time. Nor was his work without influence on the early structuralist writers. Whatever the intellectual influences upon Iengar, the latter part of his tenure at the Bank coincided with some dispersal of B.K. Madan's interests and influence within it. Madan's later writings are unmistakably influenced by Keynesian and structuralist ideas. But he, unlike several Bank and government economists of the time, had never been to Cambridge. And though not immune to more contemporary influences, Madan came closest at this time to being a traditional central bank economist. In the early 1960s, Madan's was still a major influence helping to form the Reserve Bank's views on commercial banks' capital adequacy and liquidity norms. But as Executive Director and later as Deputy Governor, Madan's energies were increasingly diverted to issues relating to the financing of industry. The 1960s therefore saw a steady rise within the Bank of economists who, whatever their training, were brought up to regard classical ideas with scepticism and were wont to take a more positive view of the type of State intervention in vogue at the time. The younger economists were more disposed than their predecessors to harness the financial sector

securely to development goals and priorities. The Bank thus began moving with little evident distaste towards regulating interest rates, and soon thereafter into forms of direct intervention which fell little short of physical allocation of bank credit. Though never absent from the Bank's concerns even earlier, its focus on the 'institutional dimension of monetary policy' within the context of the planning process also became more pronounced and articulate during the mid-sixties. Thus when he came to the Bank as Governor towards the middle of 1967, L.K. Jha felt immediately at home, his new colleagues at Mint Road, 'particularly the Deputy Governors' agreeing with his view that

in a planned economy, overall credit control by itself made no sense and sectoral priorities had to be established. Through selective credit controls [including directed credit], keeping in view the accepted priorities, we could pursue the twin goals of development and stability.

To some extent, its recent intellectual journeys too, made the Bank more complaisant with regard to the government. To quote L.K. Jha once again, the Reserve Bank was 'bound to finance the budgetary deficit of the Government'.

What needs emphasizing is not the independence of the Reserve Bank but the importance of a basic accord to ensure that monetary and fiscal policies work in harmony and pull in the same direction.

Differences between the Bank and the government over economic policies were not altogether absent. For example, the Bank never approved of the substitution of financial planning by a kind of 'physical planning'. Once it awoke to the consequences of physical targeting during the course of the second plan, the Bank strove to trim the size of subsequent plans to match visible resources. But its general attitude of complaisance meant that harmony was achieved and areas of potential conflict minimized because, to extend Jha's metaphor, where the government pulled, the Reserve Bank generally followed.

VIII

A major area of discord between the Bank and the government in the late 1950s related to the financing of cooperatives and the pattern of organization of primary lending agencies. This controversy was marked by the consolidation of the views of several departments of the government, including the Planning Commission and the Agriculture Ministry, against those of the Bank and by

interventions by Jawaharlal Nehru and the National Development Council in defence of the position staked out by these departments.

The principal recommendations of the Rural Credit Survey, the progress made in implementing them until 1957, and the controversies that engulfed them thereafter have already been discussed. Here we may merely note that when successive initiatives of the Planning Commission and the Ministry for Community Development and Cooperation threatened to destroy what in its opinion was an important plank of the Rural Credit Survey recommendations, viz. the viability and integrity of primary cooperative credit institutions, the Bank felt moved to resist their efforts. This battle was however one which the Bank had to wage on its own, since its views evoked little support from successive Finance Ministers. While TTK believed cooperation was some form of 'collectivism', his successor Morarji Desai had little sympathy for the Bank's preference for large, viable primary credit societies. In November 1958, the National Development Council passed a resolution which advocated a new cooperative policy based on small, multi-purpose village societies and financing farmers freely and, in Mint Road's view, without regard to prudent cooperative or banking principles. For a brief moment, a gloomy Bank contemplated responding to these setbacks by withdrawing into itself. Although there was 'no question of withdrawing cooperation' to the government, the Bank's executives felt that they could not now help formulate annual plans for the cooperative sector without being implicated for the new policy. But in the end, as pointed out in chapter 8, Iengar and Venkatappiah decided to engage central government departments, state government officials, and well-known cooperators in a series of discussions on the subject. These efforts were not altogether unsuccessful, and appear to have educated the Bank in an important aspect of contemporary realpolitik: with the widening of its arena of domestic responsibilities and the proliferation of institutions dealing with each of these, the Bank would now have to fight its battles not so much through the exchange of carefully drafted memoranda between North Block and Mint Road, but in the back-rooms of conferences and meetings.

Iengar was nothing if not a cultivated back-room negotiator who possessed a great capacity for persuasion. His interests were wide-ranging, and he commissioned the Bank's officials to write, frequently for his own education, studies and notes on a variety of subjects. But because the sites of decision-making were now shifting increasingly to more or less informal meetings, the paper trails Iengar initiated often dry up abruptly.

As Governor, Iengar pursued with vigour his efforts to increase the Bank's influence as the means to promote its ability to preserve monetary stability. It was also during Iengar's tenure as Governor that the Bank's influence came

increasingly to be exercised through the Finance Ministry rather than directly. Thus, while growing popular expectations from the government may have motivated the Bank to use active policy intervention alternately as sword and shield, the resulting closeness of its engagement with government departments perhaps also forced the Bank to look to the Finance Ministry as a buffer against the pressures of populism.

The paradox in the Bank's reasoning was not as great at the time as it might seem in retrospect. The impact of deficit financing on monetary conditions and policy had by now become a major source of concern at the Bank. As Finance Minister for the first few months of Iengar's term in office TTK, unlike Deshmukh before him, opposed deficit financing because it put 'more pressure on an economy where strains have already developed'. Morarji Desai, who succeeded TTK and remained Finance Minister during the remainder of Iengar's term as Governor, was also averse to large deficits. Thus, whatever the eventual outcome of his efforts, Iengar's vision of an alliance between Mint Road and North Block was not altogether unrealistic. But problems arose because Iengar took the Bank deeper into the alliance than even he may have perhaps wanted.

Morarji Desai had served as Iengar's junior official in the Bombay government and the two men tended, especially in the background of the Mundhra affair, to be somewhat guarded in their relations. These appear also to have worsened during the latter part of the Governor's term in office. But Iengar and TTK, as we noted above, managed in the course of the early months of 1957 to establish a close, if somewhat unequal, working relationship. TTK's other key adviser during these months was H.M. Patel, the Principal Secretary in the Finance Ministry. Although their relations were not without tension, the three are believed to have formed a cohesive and close-knit team which managed the country's domestic financial affairs during these crucial months. Thanks to this cohesion, Iengar succeeded in defending an important Bank interest as it was perceived at the time, namely its role as the apex lending institution for rural credit, from erosion. He also managed during these months to initiate the process of expanding the activities of the State Bank of India in ways that complemented the Bank's own perceived strengths rather than competed with them, and of taking over the state-associated banks. Monetary policy too, it appears, was formulated with little overt tension. The long-delayed increase in the Bank rate was effected in May 1957, significantly before the central government entered the market with its loans. At the same time, the stamp duty on usance bills which had caused so much grief earlier, was reduced to a fifth of one per cent.

This state of affairs was too good to last. TTK's team was rudely broken

up as a result of the so-called Mundhra affair. TTK himself resigned as Finance Minister in February 1958. Patel fell a victim to the informal processes of decision-making the Finance Minister favoured at this time, and though no charge of wrongdoing was brought against him in the end, was scarred for life by the affair. Iengar managed to keep his job, though not without some damage to his reputation. Whether he came under an undeserved cloud or was fortunate to escape the worse fate that befell his supposed collaborators depends really on the view one takes of Iengar's role in the decision to invest LIC funds in the Mundhra companies. But the Mundhra affair seems to have brought home to Iengar, as it did to his successor, the dangers of associating the Reserve Bank too closely with the government as a means of influencing its policy. Indeed, as a fallout of the Mundhra affair, Iengar went into some kind of isolation—'boycott' is the term he himself used to describe his social life in Bombay after the event—while the Bank drew back from its involvement in overseeing the stock, commodities, and bullion markets.

Relations between the Bank and the Finance Ministry were for some time thereafter, correct rather than close. The Bank now began dealing with the Finance Ministry more at the level of its civil servants than at the political level, and with some interruptions this trend continued for the remainder of the years covered by this volume. This meant, in the beginning, a certain diminution in the Bank's standing and influence, and a significant reduction in its access to the corridors of political power. The denouement TTK had so assiduously sought in 1956 thus came about more than two years later, in circumstances the former Finance Minister could not have greatly relished. The lowering of the Bank's representative profile also meant a greater formalization of its links with the Finance Ministry and perhaps, to some extent, their insulation from political and other storms brewing in Delhi. This accorded with Bhattacharyya's own preferences. Though he shared a good personal rapport with both Morarji Desai and Krishnamachari and played a major role in piloting the country's external economic diplomacy during his last two years in office, Bhattacharyya unlike Iengar appears to have been content for the most part to deal with delegated officials of the Finance Ministry, while addressing the political leadership directly about the most important issues.

On the other hand, thanks to the pervading sense of crisis in the mid-sixties, civil servants in government were in a better position than in the past and relative to their political masters, to influence economic policy. This led briefly to a striking ascendancy in the Bank's influence over economic policy, which was exerted to some extent directly through the newly created Prime Minister's Secretariat headed by L.K. Jha. As Governor,

Bhattacharyya was instrumental, along with Jha and one or two other officials, in formulating economic policies during these critical years and in negotiating assistance from the international agencies. Although the Bank itself was scarcely involved, the Governor also played a central role in the discussions leading up to the devaluation of the rupee in June 1966. His correspondence files for this period contain copies of three letters drafted at the Bank. These letters, which Bhattacharyya handed over to the Prime Minister sometime in June 1965, were intended to be sent over the latter's signature. The first of these letters requested chief ministers to reduce their states' overdrafts. The second urged the Union Commerce Minister to closely regulate the issue of import licences. Most clearly illustrative of the Bank's new authority was the third letter. This was addressed to the Union Finance Minister, T.T. Krishnamachari, and dwelt at length on the need to reduce expenditure in the face of falling revenues in order to ensure that there was no recourse to deficit financing during the year! Sachindra Chaudhuri, who succeeded TTK as Finance Minister after the latter's resignation in December 1965, is also said by some to have been the Governor's nominee for the crucial cabinet position.

Bhattacharyya did attempt to translate the Bank's new influence into a measure of autonomy. Its interest rate policy, for example, came rather more into its own during these years. The Bank rate which had remained quiescent since May 1957 was put up first in January 1963, and twice during the 1964-65 busy season, on the latter occasion in February 1965 by a full percentage point. But its ascendancy notwithstanding, these years did not lead to any enduring changes in the Bank's relations with the government, and it retreated to the sidelines with the restoration of more normal economic conditions and Bhattacharyya's departure from Mint Road at the end of his term.

IX

Superfluous to say, the autonomy of a central bank is, in the ultimate analysis, reflected in the autonomy of its monetary policies. In general, the autonomy of a central bank may come under challenge from two quarters: first as traditionally and at present understood, from a government which disregards, say, price stability or exchange rate stability while pursuing an expansionary fiscal course which the central bank is forced to accommodate or whose monetary consequences it may have inadequate powers to regulate. Secondly, as many economists would argue, the ability of a central bank in a small, open economy to conduct autonomous monetary policies is constantly

under challenge from the pressures emanating from larger markets and economies.

These two aspects of central bank autonomy are not entirely unconnected. They in fact mirror each other in some respects. Given its relative lack of autonomy, the central bank of a small, open economy has often little choice but to follow policies initiated by the bigger central banks. On the other hand, the former is more likely to be independent of its government since it is generally responsible for preserving domestic price or external stability. Conversely, when external transactions are strictly controlled, there are fewer structural and institutional constraints on the degree to which a government can force the central bank to submit to its dictates.

India was essentially a closed economy during the years covered by this volume. Economic policy-making could thus afford to be largely indifferent to the direct impact of policy on the capital account of the balance of payments, or since the economy was not in a state of 'fundamental disequilibrium' during much of this period, on the exchange rate. Nor did external imbalances obtrude persistently on the minds of Indian policy-makers so long as external reserves were large or the aid environment appeared favourable. Sluggish export behaviour, rising export subsidies, hidden capital outflows, the rapid increase in gold smuggling, and declining current account receipts emphasized the need for preserving or restoring external balance, but did not fundamentally determine it until the mid-1960s.

In this environment, monetary policies were geared fundamentally towards helping to finance public expenditure. As pointed out above, the Bank's uncritical acceptance of the need for large plans financed to a considerable extent through deficit financing owed partly to the prevailing ideological climate. Most sections of society supported the objectives and strategy of central planning, and so great was the grip which the planning process exercised over the imaginations of policy-makers and the Indian elite that for agencies such as the Bank, commitment to contemporary planning exercises was partly a precondition for establishing and sustaining their own relevance. As Rama Rau (whose views were clearly not those of the Congress party as reflected in the Nagpur and Avadi resolutions) saw it, rapid development was the key to the survival of the 'democratic system'.

We must, therefore, be prepared to face a certain measure of inflation and must devise appropriate monetary, fiscal, and possibly administrative measures to ensure that the inflationary situation does not get out of control.

Rapid planned development, Rama Rau also informed the Fund-[World]Bank meeting in September 1955,

was imperative [for India] ... from the economic as well as the political point of view. We have established a democratic system based on adult suffrage. The masses, the vast majority of whom are ill-fed and ill-clothed, have become politically conscious. The 'pathetic contentment' of the masses, which a British statesman described many years ago as characteristic of rural India has disappeared, and there is evident a new outlook on life and a demand for a higher standard of life. We have to demonstrate that within a democratic structure we can develop at a pace comparable to the totalitarian countries. An increase of 25% in the gross national product [which the second plan envisaged] is about the minimum that political conditions demand in India. We are determined to make a supreme effort to reach the target by democratic processes. With five years of peace and a reasonable measure of foreign assistance, I have no doubt that we shall succeed.

Events did not bear out Rama Rau's hopes. The earlier consensus about the role of the State in the development process too, began slowly to crumble towards the concluding years of the second plan. Within a few years wider western support for the broad strategy of planning also grew more qualified. But the domestic consensus proved sufficiently durable until the mid-1960s, so that while the Bank's attitude towards several aspects of the planning process turned more critical, it remained fundamentally supportive throughout these years.

To a large extent, therefore, monetary policies (and indeed the central bank itself) were regarded as instruments to help the country achieve certain national goals. As well as the tremendous optimism and hope with which the planning process was received, there was implicit popular faith that the policy-makers in government would do nothing, fundamentally, to upset economic stability. Many contemporaries voiced misgivings about the validity of some assumptions on which the plans—particularly the second plan—were based. Ambitious plans were also derided as a gamble which depended for its outcome on factors outside the control of Indian policy-makers. But not only were such doubts swamped by the wider measure of support for the idea of planning and the feasibility of the planning exercise, their existence underlined the important role that responsible public agencies, including the Reserve Bank, had to play in ensuring the success of the planning process.

The impact on Bank officials of the dominant economic doctrines of the day was strengthened by the actual behaviour of prices during the first plan years. After the inflation of 1950–51 was spiked, prices tended generally to be stable or head downwards despite deficit financing having accounted for nearly a seventh of the first plan outlay. Cereal production too, was above the plan target, while there was a small net accretion to foreign exchange reserves during these years. Buoyed no doubt by these trends, the Reserve Bank, as already pointed out, actually loosened the purse-strings of the central government early in January 1955.

Speaking in 1960 more than three years after he was forced out of office, Rama Rau regretted the Bank's lack of control over the central government's deficit financing operations which were determined 'solely' at the latter's discretion. Although Rama Rau's successor felt anxious about the effects of this abdication on fiscal discipline even in 1957, these were not felt until much later. Neither the realized size of the second plan nor the quantum of deficit financing, which were both below target, tells the story of a spendthrift government bankrolled by an indulgent central bank. The real act of abdication, to the extent it took place in connection with the second plan, was committed when the Finance Ministry allowed its loose resources arithmetic to go through into the final plan document. As such, the Bank's willingness to loosen the central government's purse-strings is cited here only to illustrate the spirit in which the two institutions worked during these crucial years. An assumption within the Bank, which the government made explicit more than once during these years, was that plan targets, resource mobilization exercises, and deficit financing projections had legislative sanction which was renewed each year when Parliament considered and passed the budget. It did not occur to the Bank at least until the middle of the second plan, and that too more in the context of the problems state governments faced in raising resources for their plans than in relation to central finances, that the political and institutional dynamics of the planning process could subvert considerations of fiscal prudence; and that once a plan had been passed without serious consideration being given to its financing aspects, the Bank and the Finance Ministry would be driven by the resulting political momentum to ensure that inflows into the government's coffers matched expected outflows.

Midway through the second plan, the Bank (as pointed out in chapter 2) tried to prevail upon the government to reduce the size of the plan. While the latter was pared down to some extent, its experience during these years contributed to the Bank's resolve to be consulted about the resources aspects of subsequent plans. Such consultations inevitably drew the Bank more deeply into the planning process. This meant closer coordination with the Finance

Ministry, since the two institutions shared several perceptions in common and were both keen to ensure that the Planning Commission did not once more 'bump up the size of the plan' or set unrealistic resource targets which they would have to help meet through higher taxes, larger market loans, and high levels of deficit financing.

Deservingly or otherwise, the Bank's reputation in Delhi was that of a conservative institution which was not attuned to the challenges of planning. Besides, given its distance from the corridors of political power, the Bank often relied on the Finance Ministry to weigh in on its side in disputes with the Planning Commission and other government departments. It would be surprising indeed, if this had also not led to some dilution of the Bank's independence vis-a-vis the Finance Ministry. Secondly, thanks now to its closer association with the planning process, the Bank was implicated more deeply with the responsibility for helping to fulfil its targets. As a result of these factors, though led by independent-minded Governors who faced little effective challenge to their personal standing for the most part of their terms, the Bank had willy-nilly to trim the sails of its policies to the economic winds blowing from Delhi. In effect and over the longer period, this meant supporting the financial needs of the government, including by keeping interest rates artificially low to facilitate government borrowing, and offsetting the expansionary impact of public expenditure by squeezing the private sector's demand for credit from the banking system and curtailing the availability of bank credit to this sector through a panoply of direct instruments of control.

X

The Bank's willingness to accommodate the central government not only threatened its ability to conduct independent monetary policies, it also greatly complicated its relations with state governments. As pointed out in chapters 5 and 6, there was an important difference between the Bank's relations with the central government and those with the states. While the Bank was obliged to discharge banking and other functions on behalf of the central government, statutory provisions about state governments' banking arrangements were permissive rather than mandatory. However, with one solitary exception, state governments entered into agreements appointing the Bank as their banker.

As well as performing routine agency and banking functions, the Reserve Bank helped float state governments' loans, made advances to them, and tolerated to a great extent their propensity to draw unauthorized overdrafts. The first and third of these were enduring sources of friction for the Bank's relations with state governments.

Both issues arose prominently against the backdrop of differences in the Bank's roles with respect to central government and state governments' finances. For example, while the Bank was authorized to hold the rupee securities of the Government of India in its Issue Department, it could not accord similar treatment to securities issued by state governments. The Bank might hold the latter on its own account. But there were limits to the quantities of such paper it could hold in this manner, and consequently on its ability to intervene, even should it so desire, in the market for state government securities. Such differences in the treatment the Bank accorded to different categories of gilt-edged stock remained a sore point with state governments, particularly after the mid-1950s when the size of their loan issues expanded to finance larger plan outlays. The pressure to float large loans led some state governments to force them upon unwilling subscribers. As such subscribers took the first opportunity thereafter to unload these assets, the latter often went into discount soon after their issues closed. This led, inevitably, to a clamour from many states for Bank intervention to stabilize their loans, especially as these were floated to fulfil targets set by the Planning Commission. This the Bank could not do without further assisting the erosion of fiscal discipline in the states.

The Bank took various measures to promote the market for state government loans. From the early 1950s it began buying limited quantities of such stock at the time of issue. The Bank attempted regularly, but with limited success, to reduce the size of states' loans. It also attempted to even out the market for state government paper since the loans of some state governments were better regarded than others. But in general the Bank was wont to insist upon state governments financing its intervention to stabilize the prices of their securities.

The more important bone of contention between the Bank and state governments was not unrelated to the conditions the latter faced in the market for their loans. As described in chapter 6, the Bank made ways and means advances to state governments which, unlike in the case of loans to the central government against ad hoc treasury bills, were limited to a multiple of the minimum balances they held with the Bank. This limit was frequently violated in practice by some governments running large overdrafts for prolonged periods. Particularly in the early 1950s, when the Madras government led the way, many overdrawn states sought accommodation facilities from the Bank similar to those extended by it to the central government. For understandable reasons, the Bank and the central government refused to entertain such suggestions. Neither carrots—in the form of larger authorized ways and means advances—nor threats—in the form of a decision by the Union Cabinet to allow the Bank to dishonour cheques issued by the offending states—proved effective. Despite

the Cabinet approval, the latter recourse was not judged by the Bank to be in the realm of practical politics; nor was the Bank inclined to withdraw, as Bhattacharyya proposed in the mid-1960s, from its role as banker to the offending states.

In 1957, the Bank's auditors objected to state governments' overdrafts being carried over from one year to the next in its books. The Bank therefore attempted to persuade state governments to eliminate their excess drawings by the end of June each year. This was however not possible without the central government taking over each June the unauthorized debts state governments owed to the Bank. Although in principle such payments were to be adjusted against resource transfers from the central government to the states, in practice the latter managed to postpone that day of reckoning in one way or another. With the result, not infrequently and to a not insignificant extent, unauthorized overdrafts of state governments were replaced by loans from the Bank to the central government against ad hoc treasury bills. The monetization of state governments' overdrafts, which the Bank was determined mostly to resist, thus began to take place now in an indirect fashion.

XI

Speaking in February 1962 towards the end of his tenure as Governor, Iengar identified four areas of potential conflict between the Bank and the central government. These were interest rate policy, deficit financing, cooperative credit policies, and the management of substandard banks.

Governments and central banks rarely see eye to eye on interest rates. The Government of India was, given the large size of its borrowings, perhaps even more averse than other governments to high interest rates. Keen to support the government's budgetary operations in every way, not least because it hoped thereby to minimize recourse to deficit financing, the Bank had a realistic appreciation of the problems of 'dear money'. Its faith in the impact of interest rates on the demand for bank credit also lacked conviction. Therefore it postponed interest rate increases as much as possible, particularly until the 1960s, and generally deferred to the government on interest rate policy. But Bank-government differences over the issue were not altogether absent. In 1956-57 the Bank sought tighter policies from the onset of the busy season, but did not raise the rate until May 1957. The Bank's preference for an interest rate increase in March 1960 appears to have yielded to the government's preference for other measures. Hence the decision by the Bank to raise reserve requirements, which too led, incidentally, to a slump in the market for gilt-edged stock. The Bank did not abandon hopes of putting up interest rates in

the summer of 1960 and again towards the end of the year. But unable to overcome the government's resistance, it was forced to adopt a variety of other devices to restrict credit without directly forcing a higher borrowing rate upon the government. The stalemate continued through the latter half of Iengar's tenure as Governor, and it was not until January 1963 that the Bank rate was put up from 4 to 4.5 per cent.

Even the crisis years of the mid-1960s were not without challenge to the Bank's standing as the principal monetary policy authority. Old-timers at the Bank recall the efforts T.T. Krishnamachari made in 1964-65 to claim for the government, on grounds of privilege whenever Parliament was in session, the prerogative to announce Bank rate changes. Traditionally in India, unlike in some other countries, the Reserve Bank announces Bank rate changes which the government then conveys to Parliament should it be in session at the time, and Bhattacharyya saw in TTK's suggestion an effort to usurp an important responsibility of the Reserve Bank. Iengar feared in the beginning that Bhattacharyya would not be able to 'keep his end up vis-a-vis ministers in Delhi'. But made of sterner material and refusing doggedly to yield to the minister on this issue, Bhattacharyya is reported to have insisted on retaining the Bank's right of precedence in announcing the Bank rate. In retrospect the Governor's action might be viewed as a merely symbolic assertion by the Bank of one of its few remaining privileges. Symbols are not unimportant, and its inability to build on its 'symbolic capital' after the mid-1950s may be regarded as one of the Bank's failings in later years. But Bhattacharyya's stand also had an immediate significance since the Bank's interest rate policy was now showing more promise than at any time in the recent past of coming into its own, and the freedom to make Bank rate changes would have meant little in the absence of that to announce them.

Differences between the Bank and the government over deficit financing and cooperative credit policies have been discussed at other places. Suffice it to note here that although Iengar cited 'indiscriminate expansion of rural credit schemes' (and 'special measures to finance small-scale industries') as being at the heart of his 'steadily more difficult relations' with Finance Minister Morarji Desai and others in Delhi, contrary to his fears, differences over such matters narrowed somewhat in subsequent years, thanks largely to the fact that the cooperative credit movement never realized its potential sufficiently as to lend much practical meaning or significance to them.

The reorganization of sub-standard banks is discussed in chapter 12. It is worth recalling here that the Bank was committed, at least initially, to a programme of consolidation, but the pace at which it sought to consolidate weak banks soon became unacceptable to the government. The latter's

preference for a more cautious policy was motivated partly by the fear that consolidation would promote concentration in the banking industry and the elimination of smaller, more local banks. Once again it did not prove impossible to balance the Bank's considerations with those of the government, though the outcome reflected the government's position more than it did the Bank's preferences. To some extent, of course, this had now become something of a norm. But in this particular case, the consensus also reflected the Bank's continuing sensitivity towards the need to expand banking facilities throughout the country. The conflict between the safety of depositors' funds and the rapid expansion of banking also became easier to reconcile with the institution of deposit insurance, an intricate system of regulated interest rates, and more effective supervision over banks.

XII

An important justification for writing a retrospective account of the functioning of a public institution is founded on the principle of accountability. The latter, however, should not be understood narrowly, or merely in the sense of submitting the decisions and activities of an institution in one period to the judgement of the next. Rather, the certainty of historical scrutiny represents a stringent form of accountability for a public institution because, by promoting transparency, it might enhance the spirit of public purpose motivating its actions.

The preceding pages speak for themselves, and it is not necessary to dwell at any further length upon the extent to which the Reserve Bank's activities during our years were informed by a high sense of public purpose. Nor were they bereft of significant achievement. To take but one example, in the early 1950s the Bank was heir to an immense 'moral prestige', to use the first plan document's expression, and a poorly developed financial system in which the majority of the banks bordered on a state of crisis and disorganization, and whose reach did not extend beyond the major towns and cities. There was also no adequate mechanism to channelize capital for the needs of agricultural and industrial development. Its prestige the Bank translated into a series of positive initiatives to promote institutions purveying a variety of credit both to agriculture and industry. The Reserve Bank was also instrumental in transforming the banking system and placing it on secure foundations. The resulting financial deepening and widening of the Indian economy was perhaps the Bank's most lasting accomplishment during our period. In 1950, assets of financial institutions amounted to about a third of the gross national product. Seventeen years later this proportion had gone up to over half. The ownership

of these assets also grew more diversified, with the Reserve Bank's own share of the assets of financial institutions falling from about half at the beginning of our period to just over a quarter at the end, and from 16 per cent of the national income to nearly 14 per cent.

The Reserve Bank regarded financial deepening (and widening) as the 'institutional dimension' of its monetary policies. India's relatively modest rates of inflation until the mid-sixties suggests that the Bank was not unsuccessful even in its pursuit of the more traditional goal of monetary policy. But the price of this success was a credit policy regime which relied increasingly on an elaborate set of direct and discretionary controls and sectoral direction of credit to support the financial needs of the government, while closely regulating or restraining the flow of credit to commerce and industry.

These years also saw the Bank progressively surrender its autonomy to an expanding—some may say rampant—central government apparatus. On the other hand, the institutional independence of the central bank is considered desirable for its own sake today partly because of our experience of its lack during the last four decades and more. Few, say in 1955, would have sympathized with the suggestion that the central bank should, rather in the manner of the judiciary, exert itself as a form of an independent check or balance even on the excesses of executive authority in government, let alone on budgetary or plan programmes voted by the Parliament of the day. Other central banks too were guilty of self-effacement during these years. With one or two possible exceptions, these institutions saw their role as one of assisting governments to maintain full employment, rather than merely mind the rate of inflation. The relatively closed nature of national economies even in the industrialized world, many among whom retained capital account controls in some form or the other until the 1980s, afforded central banks the luxury of yielding their judgement to that of officials in government, and more generally of departing from the principles they traditionally preached.

As well as being guided by prevailing central banking philosophies and trends in other parts of the world, the Reserve Bank of India had also to exercise its responsibilities with an abiding sense of relevance. Practical ideas command acceptance only because they are judged to be relevant to the needs of contemporary society; and institutions are often less able than individuals to forsake relevance for the splendour of isolation. Institutions too, can rarely survive on dogma alone, especially when it is widely believed to have been superseded by recent experience. It is therefore hardly to be wondered at that both on intellectual grounds and the practical, the Reserve Bank felt the need during these years to identify itself closely with the needs of the government. Undeniably, however, in

some respects, the embrace was uncomfortably close. The Bank also gave up, without much thought, important institutional means of checking fiscal profligacy, and undermined thereby the independence and effectiveness of its own monetary policies in the longer run.

The history of the Reserve Bank of India during the 1950s and 1960s thus holds important and abiding lessons not only for our own present and the future, but also more widely for other central banks and the financial sectors of developing economies. Each generation has its own yardsticks with which to measure success; while their legacies in the present provide a basis using which to evaluate the failures of the past. Therefore, while helping to sum up the pasts they describe, these pages must inevitably reflect our preoccupations in the present. Yet, the process of learning also requires us to be sensitive to the needs and attitudes of the past, and the relatives against which we would like posterity to weigh our own interventions in the present. Thus, where the Bank's history is concerned for its own sake, it is useful to bear in mind that it was the climate of the times which determined its attitudes and actions, and it is by the standards of those times that these should be judged.

Unpublished Sources

Apart from the material used in the other chapters and appendixes, the following sources have been used.

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HC/RR/1 Resignation of B. Rama Rau

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