On 20 July 1969, the Indian government nationalized fourteen private sector banks. By any measure, this was the defining economic event of not just the 1960s but the next three decades. Its reverberations have still not died down. It remains, without doubt, the single most important economic decision taken by any government since 1947. Not even the reforms of 1991 are comparable in their consequences—political, social and, of course, economic.

From 1951 to 1966, in an effort to consolidate commercial banking, which was very fragile, the number of commercial banks was brought down sharply. In 1951, there were 566 banks; by 1967, just 91 were left. (An account of this process is provided in Volume 2 of the history of the Reserve Bank of India.) It was, on the whole, a successful endeavour. By the mid-1960s, Indian banking had become far more viable than it had been ever before.

This did not, however, mean that the spread of banking also reduced. On the contrary, there was an increase in the number of branches—from 4,151 to 7,025 during 1951–67. There was thus a significant and palpable increase in the availability of banking facilities, with the population per branch office declining from 1,36,000 in 1951 to about 75,000 in 1967. But there was one important snag: the expansion of branches was mostly in urban areas, and rural and semi-urban areas continued to go unserved. As a result, a number of economic activities, in sectors ranging from agriculture to small-scale industrial units and the self-employed, did not have proper access to banking facilities.

This led to the widespread political perception that, left to itself, the private sector was not sufficiently aware of its larger responsibilities towards society. The political class became convinced that privately owned banks needed to be informed of the societal requirements of credit. Private banks were seen as being excessively concerned with profit alone, which made
them unwilling to diversify their loan portfolios across different scales of operation of economic units, as this would raise transaction costs and reduce profits.

THE ROAD TO ‘SOCIAL CONTROL’

The idea of ‘social control’ of banks, as it first emerged in 1967, was the result of a compromise between two extreme viewpoints on banking held by the political class, then mainly represented by the Congress party. The Economic Programme Committee of the All-India Congress Committee (AICC), in its report submitted in 1948, had strongly recommended that banking and insurance should be nationalized as part of a total package for establishing ‘a just social order’. This recommendation was endorsed by the AICC at its meeting held in Bombay in April 1948 and also at the annual session held in Jaipur in December 1948. But there matters rested for a decade and a half.

In March 1963, just after the war with China, which India lost and as a result of which a huge budgetary cost was imposed, the government suddenly found itself short of resources to fund the Third Plan. In the ensuing debates Subhadra Joshi, a senior member of the ruling party, brought a non-official resolution asking for nationalization of private banks. This would mobilize resources for development, she said. T.T. Krishnamachari was Finance Minister then. He responded that nationalization by itself was not likely to provide much additional income to the government.

The events of the next four years are critical to an understanding of the political events that led to the nationalization of banks, and it is worth summarizing them here. As stated above, India was recovering from the disastrous defeat at the hands of the Chinese in October 1962. Its treasury was almost empty, and public and political morale were low. Prices were once again starting to rise, forex reserves were dwindling and there was a mood of general dissatisfaction with the government. Then, on 27 May 1964, Jawaharlal Nehru died. Lal Bahadur Shastri became the Prime Minister even as, internally, the Congress leadership began to conduct an intense succession battle. In June 1965 Pakistan attacked in the Rann of Kutch and was repulsed. Worse still, the monsoon failed. Even before the full enormity of this second disaster had sunk in, Pakistan attacked yet again in September that year, this time in Kashmir. The resulting war was a stalemate but the toll it took of public finances sealed the Third Plan’s fate. Then, two and a half months before the fiscal year ended, on 11 January 1966, Prime Minister Lal Bahadur Shastri died of a massive heart attack in Tashkent.
where he had gone for peace talks with Pakistan. He was succeeded by Indira Gandhi. She owed her position to a ‘Syndicate’ of senior Congress leaders. Groomed for the job by her father from about 1955 onwards, Indira Gandhi had refused the offer in 1964. It would not look nice, she had told some of her advisors.

Her first year in office was perhaps the worst since Nehru’s in 1947, although for very different reasons. In a space of twenty months India had lost two Prime Ministers, fought two wars that came on top of an earlier one in 1962 and was grappling with a major drought. For the next two years, drought persisted. Then a balance of payments crisis broke. By 1966 budgeting became notional. Planning was put on hold for three years. In the 1967 general election, the Congress lost a large number of seats in Parliament. War, famine, political uncertainty, economic distress—the cup of misery was brimming over. Indira Gandhi, resenting the control of the Syndicate and requiring to assert her leadership, restore the authority of the government and rebuild the Congress party, needed a dramatic gesture that would revitalize the hopes of the nation and put her firmly in control.

The objective she chose was the vote and support of the poorest, and the instrument she chose to achieve this was bank nationalization. The election manifesto of the Congress party for the 1967 election declared that while those who held the levers of economic power would also ultimately run the political apparatus, it was necessary to bring most of the ‘banking institutions under social control to serve the cause of economic growth more effectively and to make credit available to the producers in all fields where it is needed’.

So, through 1968, Indira Gandhi orchestrated the demand for nationalization; by the start of 1969, it became clear that she and Morarji Desai, her Deputy Prime Minister and Finance Minister who was steadfastly opposed to nationalization, would have to part ways. Soon after presenting the budget for 1969, Morarji Desai resigned. Within a few months, the political crisis that had been brewing for about a year, finally broke.

In July that year, the party split into two factions, one led by Indira Gandhi, projecting herself as a revolutionary saviour of the masses, and the other by the Syndicate, now portrayed as being anti-people and pro-rich. To drive home her point, Indira Gandhi assumed the Finance portfolio, rightly calculating that she could shoot at her targets far more effectively. Just how determined she was to win the political battle was brought home to the nation when she presented the budget for 1970–71 on 28 February 1970. It put India on a course from which it has still not been able to steer away completely.
THE RUN-UP TO NATIONALIZATION

The results of the 1967 general election, in which the Congress lost many seats in Parliament and had to give up office in several key north Indian states, led to sharp introspection. At the Congress Working Committee’s meetings held in the second week of May 1967, economic issues came up for serious consideration. Many of the members, who held sharply divergent views, wanted to know exactly what the party’s goal of ‘democratic socialism’ meant and how it was to be achieved. Bank nationalization became a focal issue. Some thought banks should be nationalized without much further ado because, otherwise, it would be impossible to ensure adequate credit facilities for deserving units, whether in the small-scale sector or the large sector. But their opponents said that the Reserve Bank already had enough control over banks and that nationalization would not in any way hasten the process of democratic socialism in the country. A third group played the mid-field, favouring social control of banks and nationalization of general insurance.

After detailed discussions, the Congress Working Committee (CWC), decided to go in for increased participation in banking, foreign trade, insurance and foodgrains distribution. As a first step, the Reserve Bank’s control over scheduled banks was proposed to be tightened, and the lending portfolios of banks were to be modified to provide liberal credit facilities to the middle and lower middle sectors of industry, trade and agriculture, and, in particular, to ensure that small farmers, small traders and small industrial units were not starved of credit.

Many senior members pressed for urgent steps towards a take-over of private sector banks. Y.B. Chavan, Jagjivan Ram and K. Kamaraj were for immediate implementation of the promise made in the Congress manifesto regarding social control of banks. Morarji Desai, the Deputy Prime Minister and Finance Minister, conceded that the promise made to the electorate had to be fulfilled but pleaded for adopting a cautious approach. He argued that there was already criticism of the inefficient working of the public sector in general and of the State Bank of India in particular, and, therefore, it would be unwise to burden the administration with the control of 94 private banks in the country, as it would pose enormous problems of integration and fitment of salaries, and efficient running of the banks. He explained that he was behind nobody in progressive thinking and action but proper and effective steps must be taken to achieve this end. Finally, he was able to persuade the members that the socialist goals identified by the CWC could be achieved by greater control of private banks
without taking them over, and assured them that preparatory steps would be taken towards reaching the goal envisaged in the election manifesto in a gradual manner. Concurrently, the demand for nationalization was raised in Parliament as well. The government said that it was in agreement with the spirit of the idea but wanted to institute a study first into the nature and extent of power it had over the banking institutions. It also informed the House that the government was examining the resolution of the CWC on control over credit and insurance institutions, and the various methods through which this objective could be achieved. Thus did the Finance Ministry buy time.

V.A. Pai Panandikar, Advisor in the Finance Ministry, was asked to conduct the study required by the CWC’s resolution on social control over banks. He was not given any instructions regarding the scope of his work but was to examine all aspects, including nationalization. Indira Gandhi, though not actively participating in the debate, as will be seen, shaped the course of events by silent and skilful planning.

Morarji Desai favoured social control over banks but saw the writing on the wall. He convened a meeting of leading bankers on 18 June 1967, at New Delhi. Among those who attended were Krishnaraj Thackersey, President of the Indian Banks’ Association, Kamalnayan Bajaj, A.D. Pai, R.D. Birla and M.P. Birla. This, Morarji hoped, would blunt the edge of the demand for nationalization. He asked the private banks to facilitate the flow of credit into socially desirable sectors and not to fritter away funds by financing speculation in seasonal commodities. He also asked them to take steps to ensure that they had sufficient funds with them at the beginning of the busy season by rationalizing their credit policies during the slack season, so that the return of funds during the busy season was adequate. He suggested that credit facilities for small-scale industries and for small agriculturists should be liberalized, and that banks should accept the technical skills of a promising entrepreneur as sufficient security for accommodation. He gave them six weeks to formulate their suggestions on ways to achieve the objectives outlined by him, and made clear the government’s determination to tighten its grip on banks and to attain greater social control. The bankers assured him of their cooperation. A little later, a similar meeting was held in Bombay also.

The bankers, naturally, were concerned about the prospect of ‘social control’. The chairman of the Indian Banks’ Association (IBA), which did not include the State Bank of India, wrote to Indira Gandhi saying that the powers already vested with the Reserve Bank were ‘so extensive and comprehensive’ that there was hardly any scope for adding to them or for
further extending social control over banks. These powers, he said, included determination of the policy on advances, and directives regarding the purposes for which advances could be made, margins to be kept and the rate of interest to be charged. There were several other ways in which the RBI controlled the banks, he said, including guarantees that might be given on behalf of any one company or individuals by any bank; inspection of a bank thoroughly and without previous notice, and ordering the bank to rectify actions that it considered unsound, unsafe or anti-social; and issuing directives to any bank to safeguard the public interest and the interests of depositors, and to secure proper management and working of the bank.

The IBA was stung by the criticism that the banks were not lending enough to agriculture and small industries. So, in July 1967, it seriously considered proposals to establish two corporations—a Farm Finance Corporation and a Small Industries Finance Corporation. Ultimately, only the Agricultural Finance Corporation was set up. In August 1967, the IBA also placed a series of newspaper advertisements to rebut the arguments advanced in favour of social control. It claimed that 89 per cent of the borrowers were small, each having a limit of less than Rs 50,000. It also said that banks had never been expected to finance agriculture but had nevertheless been assisting agriculture, albeit modestly. The IBA then posed the critical question: if savings account depositors were exposed to reckless risks there might be financial panic and crisis of confidence, and, further, if political or legislative processes precipitated issues and forced hasty, unjustified changes upon banks, the economic future of the country might be jeopardized.

These arguments were just brushed aside. The spirit of the times was against them.¹

¹ Morarji’s unbending stance made the protagonists of nationalization more active. The General Secretary of the Congress Parliamentary Party, Chandrasekhar, commissioned four economists to undertake a study of banking operations in India—H.K. Manmohan Singh, head of the Department of Economics, Punjab University; Dr V.B. Singh, Department of Economics, Lucknow University; Dr S.C. Gupta, Agricultural Economics Research Institute, Delhi University; and Dr S.K. Goyal, Indian Institute of Public Administration, New Delhi. Their report was submitted in the third week of October and said that the demand for take-over was ‘purely based on economic and social considerations’.

Their main findings were that bank credit in India had not been utilized for financing projects according to Plan priorities but invested in low priority sectors; that between 1953 and 1965, loans advanced by banks for agriculture declined not only in absolute terms but also as a proportion of the total funds; that easy and cheap availability of credit to a few industrial houses had encouraged the growth of monopolies and concentration of economic power; that the Reserve Bank had been ineffective in preventing this tendency and the Bank
THE DEFINING EVENT

The Pai Panandikar Report

Pai Panandikar submitted his draft report towards the middle of August 1967. He suggested that if existing banking legislation was suitably amended, the objectives of social control envisaged in the ten-point economic programme adopted by the CWC could be achieved. He also said that an important step towards social control of banks would be the setting up of some special institutions to provide credit to certain specified and special sectors. Simultaneously, Morarji Desai also received a report on nationalization of general insurance.

The Panandikar report was not made public but, according to press reports, after a preliminary examination, Morarji Desai concluded that nationalization was not called for and that remedial measures could effectively channelize credit to development needs. Apart from changing the institutional arrangements, more stringent control and supervision were envisaged in the report. One way of exercising control would be to ensure that the government had a voice in the appointment of bank directors. Another suggestion was that a national commission be set up to study the organization and structure of banking. Thus was born the Banking Commission.

After discussions with L.K. Jha, Governor of RBI, the final report was submitted at the end of August. The government wanted to ensure that the boards were not packed with special interests, and that they reflected all sections that had a vital stake in the balanced operation of the credit mechanism for sound economic growth.

B.N. Adarkar, Deputy Governor of the Bank, sent fairly detailed comments on the report to the government within days of its submission. The RBI had serious reservations about the need for establishing the National Credit Council (NCC), presumably because it believed that the Council had to be very cautious in exercising its regulatory powers lest public confidence in banks in general might be underestimated. The report also found that a total of 188 persons served as directors of twenty leading banks; these directors also held 1,452 directorships of other companies and the total number of companies under them was 1,100. Similarly, a detailed study of the directorships held by directors of five leading banks revealed that through common directors, these five banks were connected with 33 insurance companies, 6 financial institutions, 25 investment centres, 584 manufacturing and other companies, 26 trading companies and 15 non-profit-making associations.

Chandrasekhar, at a press conference held on 24 October 1967, deprecated attempts to sidetrack basic issues like nationalization of banks and abolition of privy purses. He stated that social control of banks could be secured only through take-over of the banking business by the state.
would eventually undermine the authority of the Bank. It was, however, agreed that social control would suffice in the given economic circumstances. The Bank had disagreements with a number of other recommendations, which need to be elaborated upon.

In September 1967, the supporters of nationalization received a shot in the arm from an unexpected quarter. The report of the Industrial Planning and Licensing Policy Committee that had been set up by the Planning Commission categorically advocated state control of banking.

At the risk of over-stepping my terms of reference, I should express my doubts about the viability of carrying through the above suggestions so long as many of the major credit institutions are under the direct control and/or influence of those who might suffer under the suggested arrangements. It would be difficult to undertake credit planning unless the link to control of industry and banks in the same hands is snapped by nationalization of banks

said its author, R.K. Hazari. He was then a professor of economics at Bombay University.

But Morarji Desai carried the day. The CWC, at its meeting held in Jabalpur on 27 October, whittled down the controversial elements in the party’s ten-point programme and left the basic task of its implementation to the government. The demand raised for nationalization was rejected. The Working Committee neither prescribed the form of social control nor fixed any time limit for its implementation.

The Board of Directors of the RBI had been informally discussing the issue of social control. There had also been an exchange of views between the government and the RBI. This was reflected in Governor Bhattacharyya’s letter of 2 June 1967 to Morarji. He argued against nationalization, with the caveat that it was still not practicable ‘to issue any rigid or statutory direction’ to banks to grant loans to small-scale industries or to agriculture. But he said that he intended to suggest to all the larger banks that they create development departments or cells to cater to small-scale industries. He also said that the banks would be ‘in a position to supplement the assistance provided by the cooperative banking structure and by the agricultural credit corporations, by financing certain essential inputs like fertilizers, hybrid or other improved seeds and agricultural machinery and implements’. He thought that it would be of help if an appropriate scheme of guarantee or insurance were formulated.

In July 1967, Bhattacharyya was succeeded by L.K. Jha, who had been
Principal Secretary to Indira Gandhi and had a close working relationship
with her. He convened a meeting with the chairmen and chief executives of
the leading banks on 31 July. At this meeting, Jha pointed out to the banks
that ‘what was needed was a positive redirection of credit to priority users.
Agriculture and exports were obvious priority sectors; in the industrial sec-
tor, industries that helped agriculture or stimulated export—as well as small
industries—deserved special attention.’ He added: ‘It was necessary that
the banks should understand and be in tune with these objectives. If such
understanding was there, there would be no need for written instructions
from the Reserve Bank.’ He also announced some liberalization measures
to enable the banks to enlarge their assistance to what were regarded as
‘priority sectors’.

Meanwhile, as pointed out above, Pai Panandikar’s report was causing
the Reserve Bank some irritation. Panandikar had stressed the inadequacy
of the policies and practices of commercial banks in mobilizing deposits
and in channelling funds towards the priority sectors, and gone on to say
that the Bank’s controls were more of a regulatory nature and did not have
a positive directional content. In response, the Bank in a memorandum
said that this approach reflected a lack of balance.

No doubt certain areas like agriculture and small-scale indus-
tries have received relatively less attention from banks, but it is
not fair to conclude from this, as is sometimes done, that bank
credit in India has not served as an instrument of development
or that the growth of the banking system since the commence-
ment of planning has not proceeded on the lines of national
development needs. . . . Nor is it fair to blame the bank man-
agements for failure to promote certain social objectives which
were never recommended to them either by Government or
the Reserve Bank in the terms in which they are now envisaged.

Defending itself, the RBI pointed out that following the recommenda-
tion of the Committee of Direction of the All India Rural Credit Survey,
the policy decision had been taken that further development of rural credit
facilities should primarily be through extension and strengthening of the
cooperative credit system. Further, the lower order of attention received by
the small-scale industries sector was due to the orientation of banks in favour
of large-scale industry because of the low unit cost of such lending, and this
did not amount to defiance of policy directives given either by the govern-
ment or the Reserve Bank. It said that the overall insufficiency of bank
resources, which was primarily related to the low levels of savings in the
economy, was the major hurdle in directing adequate flow of credit into the priority sectors.

What irritated the Bank the most was Pai Panandikar’s observation that there is some evidence that at least a few major commercial banks have been unduly exclusive in their lending practices. Their internal procedures are often left flexible which vest large discretionary powers in the Boards of Directors who have often acted as sources of patronage in deciding credit matters. Secondly, some of the commercial banks, though they may not have actively aided undesirable social activities, appear to have often connived at such activities. And lastly, the support of the commercial banks seems to have helped to some extent, the concentration of economic power.

The Bank agreed that the preponderance of businessmen on bank boards had afforded them an undue advantage but this did not mean that the banks connived at fostering anti-social practices. It pointed out that the main objectives of its inspections as well as of its selective credit controls were to check such practices, if any. Complete elimination of anti-social practices cannot be achieved by banking control alone, so long as substantial resources continued to be available from the unorganized sector to those indulging in such practices.

Pai Panandikar’s report had also observed that the effectiveness of the Bank’s ‘direct controls’ was ‘limited only to aggregate advances by the banks. The right of the banks to sanction limits to individuals is not in any way restricted unless it crosses the Rs 1 crore limit. As a result, the Bank often finds that its directives are not as effective as necessary.’ The RBI explained that its controls were confined not merely to the aggregate advances of banks, but were also aimed at ensuring that the level of advances of individual banks was reasonable and that the advances portfolio had a balanced distribution.

The report’s remarks on the coordination between the Bank and the government were so worded as to create an impression that the RBI had very little authority over the commercial banks. The report observed:

Although it has taken an active position for developing certain types of financing institutions like the Industrial Finance Corporation and the Agricultural Refinance Corporation, the Reserve Bank did not perceive that it was ever assigned a positive and directive role vis-à-vis the credit policy and practices of
the commercial banks either by way of the legislation or by various amendments to the Banking Regulation Act. Nor did the Reserve Bank feel that it had either the legal authority or the mandate from Government to play such positive role.

The report added:

It was also felt that at present there were no clear-cut and established channels of communication between the Reserve Bank and the Government for transmitting on a regular basis national economic policies which needed the attention of the Reserve Bank. More often than not, there was a heavy dependence upon informal channels of communication for securing broad policy guidelines from the Government. While the Reserve Bank took considerable initiative in promotional activities like setting up the long-term financing institutions, agricultural and export refinancing schemes, there was no deliberate design of directing the credit policies and practices of commercial banks towards social objectives.

The RBI refuted the charge that it had not played a positive and direct role vis-à-vis the credit policies and practices of commercial banks. In its defence, it cited the various directives issued by it that had a positive content, and that were intended to ensure that the credit policies and practices of commercial banks were oriented towards the objectives of economic policy set by the government from time to time. Sufficient powers also existed in the Banking Regulation Act for the purpose. The Bank also contended that there had always been close contact between the government and RBI in areas of monetary policy and that it had not experienced any difficulty on account of the stated lack of communication channels.

The fact was that Pai Panandikar’s report had put the Bank on the defensive. From then onwards, its relationship with the Finance Ministry would undergo a slow qualitative change, characterized, in the main, by a gradual erosion of its powers and authority.

The busy season credit policy of 1967 gave Jha an opportunity to attempt some liberalization. This included measures such as refinance at a preferential rate of 4.5 per cent per annum in respect of packing credit advances made to exporters of engineering and metallurgical products, subject to the condition that the commercial banks’ advances carried a rate not exceeding 6 per cent per annum. Moreover, refinance at the Bank rate in respect of packing credit advances to exporters of other products was
proposed, subject to a ceiling rate in regard to commercial bank advances of 8 per cent per annum. These facilities were made available irrespective of the banks’ net liquidity ratio (NLR). It was also decided that while computing the NLR, the increase in the banks’ advances to specified priority sectors and small-scale industries guaranteed by the credit guarantee organization was not to be taken into account. The RBI also rescinded its directive of October 1966 (requiring that not less than 80 per cent of incremental advances in the busy season should be to industry and against export/import bills), with a view to encouraging unrestricted credit to other sectors.

The Reserve Bank’s lead was followed by the Industrial Development Bank of India (IDBI), which, on its part, announced certain relaxations, such as extension of its export credit scheme to seven years (and up to ten years in specially deserving cases) and modification of its industrial bill scheme. Later, for the purpose of assessing the increase in advances to priority sectors, a system of submission of weekly returns to the RBI was introduced.

On the agricultural front, commercial banks were expected to commence direct financing on a large scale. The State Bank of India (SBI) had agreed to finance agriculturists directly with short, medium and long-term loans, in a few districts of Uttar Pradesh. Government of India, on its part, had issued a circular to state governments indicating that in order to enable the SBI and other commercial banks to come into the field of agricultural credit on a vast scale, it will be necessary for the state governments to provide them with certain facilities, such as administrative support for carrying out necessary pre-investment surveys, technical assistance of the agricultural department, and statutory facilities with regard to recovery of dues on the lines of the facilities available to the cooperative credit structure.

These measures, it was widely hoped, would result in quelling the demand for nationalization. But that was not to be. State control over banks continued to evoke interest. There were complaints that the bulk of commercial bank advances tended to be directed towards large and medium-scale industries, and big and established business houses. The complaints grew in strength as the demand for bank credit was accelerating while banks’ resources were growing at a relatively slow pace. The clamour for equitable distribution of the available resources assumed an increasingly strident tone. The measures taken so far in this direction were considered piecemeal and inadequate.

By December 1967, the scheme for social control was ready. On 14 December 1967, Morarji Desai made a statement in the Parliament on the
scheme. Basically, he agreed that the traditional links of banks with industrial and business houses needed to be snapped, and that credit decisions should conform to the development priorities of meeting the credit needs of priority sectors like agriculture, small-scale industries and exports. But, he said, ‘mere acquisition of the banks would severely strain the administrative resources of the government’, and the influence of industrial groups or businessmen could be neutralized by changing the board of directors. He also proposed the setting up of the National Credit Council for better planning of credit, and new powers to be conferred on the Bank.

The Reserve Bank and the Finance Ministry had even prepared the required legislation. A note prepared by R.K. Seshadri, Executive Director, on the proposed provisions of the Bill, was discussed in the Governor’s room on 4 November 1967. In light of these discussions, a tentative draft of the Banking (Social Control and Miscellaneous Provisions) Bill, as it was initially titled, was submitted by the Bank’s Joint Legal Adviser, R.M. Halasyam, on 11 November. The draft, duly revised, was sent to Adarkar on 17 November. In the meantime, on 9 November, Morarji Desai held discussions with officials of the Bank, the government and commercial banks, clarifying certain points as also explaining the major changes proposed under the scheme of social control. This was followed by meetings held by Jha with the representatives of foreign banks on 30 November, explaining the issues further.

In the interregnum, continued interaction between officials of the Bank and the Ministry of Finance at various levels sought to streamline the provisions of the scheme. On 21 November, Seshadri took with him to Delhi a copy of the Bill on social control drafted by the Bank’s Legal Department, for further consultations and finalization. Subsequently, on 4 December, the draft Bill prepared by the Law Ministry, incorporating the changes suggested by the Bank, was put up to Jha by Seshadri, with the remark that the same was being redrafted at Delhi by the Law Ministry. The draft Bill, dated 9 December, as finalized after discussions held in Delhi between 6–8 December, was titled ‘Banking Laws (Amendment) Bill 1967’.

Certain further changes were made in the printed draft as a result of discussions between the Bank’s Joint Legal Adviser and the Law Ministry on 18 December. This marked the culmination of the rather hectic interaction between the Bank and the Ministry, leading to the introduction of the Bill in the Lok Sabha on 23 December. The Bill sought to amend certain provisions of the Banking Regulation Act, 1949, the Reserve Bank of India Act, 1934, and the State Bank of India Act, 1955, for extension of the scheme of social control over banks. Simultaneously, with a view to
providing a forum for discussing and assessing credit priorities on an all-India basis, a high-level body called the National Credit Council was set up in terms of Government Resolution dated 22 December, which was published in the Gazette of India extraordinary dated 23 December 1967.

A number of letters seeking clarifications, offering suggestions and registering protests were received both by the government and the Reserve Bank after the introduction of the Bill in the Lok Sabha. In a letter addressed to Morarji Desai on 5 February, Thackersey, who was chairman of IBA, pointed out that although most of the provisions of the Bill were in conformity with the conclusions arrived at during the informal meeting with bankers, the language was in some places at variance with the intentions or objects of the Bill, and different from the conclusions arrived at in the informal meeting. He added that certain provisions of the Bill were such as to cause hardship in genuine cases and went on to furnish details on these points. He also requested that the Bill be referred to a Select Committee for considering these points.

The Select Committee, with G.S. Dhillion as chairman, after initial discussions in Parliament, held its first meeting on 1 April 1968. The meeting decided to call for memoranda from public bodies and associations so as to reach the Parliament Secretariat by 12 April. In a letter addressed to the Governor in this regard, Shiralkar indicated that it would be useful if a representative of the Reserve Bank could be present during the sessions of the Select Committee that were scheduled to take place for about ten days from 15 April onwards. Accordingly, the Bank was represented in these sittings by Seshadri in the initial stages, and later by Adarkar.

The Select Committee examined the various representations and suggestions received, and also recorded the evidence of eight parties including Jha and V.T. Dehejia, chairman of State Bank of India. The Bill, as amended by the Committee, was submitted to the Lok Sabha on 6 May 1968.

The IBA and the banking sector were more concerned about certain provisions of the newly introduced Sections 10A and 10B of the Banking Regulation Act, relating to constitution of the board of directors and appointment of whole-time chairmen, respectively; as also the substitution of Section 20 of the Act, inter alia, prohibiting banks from extending loans and advances to their directors or to any firm in which any of their directors were interested as partner, manager, employee, guarantor, etc.

On the other hand, bank employees’ associations and other trade union organizations and connected political sympathizers were agitated about the provisions of Section 36AD of the Act, which laid down:
No person shall:
obstruct any person from lawfully entering or leaving any
office or place of business of a banking company or from carry-
ing on any business there, or hold, within the office or place of
business of any banking company, any demonstration which is
violent or which prevents, or is calculated to prevent, the tran-
saction of normal business by the banking company or …

Employees’ associations/unions registered nation-wide protests against what
they perceived as an encroachment on their trade union rights. There were
also heated and prolonged discussions on the provisions of this Section in
the Lok Sabha.

The Bill, which was passed on 6 August, received the assent of the Presi-
dent of India on 28 December and, in terms of Government Notification
dated 13 January 1969, came into force from 1 February 1969.

Some of the more important provisions of the Act were as under.

Banks were required to reconstitute their boards of directors so that not
less than 51 per cent of the total number of members were persons having
special knowledge of or practical experience in certain fields such as
accountancy, agriculture and the rural economy, small-scale industry, co-
operation, banking, economics, finance and law. The directors thus consti-
tuted should not have substantial interest in or be connected, as employee,
manager or managing agent, with large or medium-sized industrial under-
takings or trading or commercial concerns. Of these directors, not less than
two were to represent agriculture and the rural economy, cooperation and
small-scale industry. In consonance with the spirit of these provisions,
every foreign bank was also expected to set up an advisory board consisting
of Indians (with the exception of the chief executive officer when he was a
member), and with a majority of the persons having special knowledge of
or practical experience in one or more of the fields mentioned above. Every
Indian bank was to have a professional banker and not an industrialist as
full-time chairman. The appointment, removal or termination of appoint-
ment of the chairman, and the terms to be granted to him, would require
the approval of the Reserve Bank.

The grant of any new loans and advances, whether secured or unsecured,
to directors or members of any committee or board appointed by the banks
in India, or to concerns in which they were interested as partner, director,
manager, managing agent, employee or guarantor, or in which they held
substantial interest, would be prohibited, except in pursuance of previous
commitments. If the director concerned continued to be a member of the
bank’s board, the loan, even if it was granted because of any previous commitment, would have to be recovered within a period of one year from the commencement of the Act; the Reserve Bank might, however, in special cases, extend the period up to three years. The appointment, reappointment or removal of the auditors of a banking company would require the approval of the Reserve Bank, and the Bank was empowered to direct the auditors to audit any special transactions that it might specify.

The Reserve Bank’s powers to appoint directors or observers and to issue directions to banks were amplified. Such directions might hereafter be issued not only in the interests of depositors or proper management of the banking companies, but also in the interest of banking policy.

Banking policy as defined in the Bill meant

any policy which is specified from time to time by the Reserve Bank in the interest of the banking system or in the interest of monetary stability or sound economic growth, having due regard to the interests of the depositors, the volume of deposits and other resources of the bank and the need for equitable allocation and the efficient use of these deposits and resources.

The government was empowered under the Bill to acquire the business of any bank if it failed more than once to comply with any directions issued to it under Section 21 of the Banking Regulation Act in regard to advances or under Section 35A of that Act in regard to any other matter concerning the affairs of the bank, and if, in addition, the acquisition of the bank was considered necessary in the interests of the depositors or in the public interest or in the interest of banking policy. There was to be payment of compensation in the event of such acquisition.

This provision evolved out of an interesting episode. On 6 December 1967, Jha had written to Morarji Desai that:

When you decided that a bank which misbehaves should be taken over, it was my impression that you wanted to see such a bank nationalized in the true sense of the term and that Government will take over the shares from the shareholders. The draft which I saw is in the nature of an extension of the existing powers to amalgamate one bank with another; so that nationalization would mean merger with the State Bank.

I do not feel happy about this. The State Bank is already a huge mammoth organization and it would not be very desirable to make it even bigger by merging any large bank with it.
More important is the consideration that the power to nationalize and therefore the liability to pay compensation must rest with the Government and not with the Reserve Bank. It is one thing for the Reserve Bank to amalgamate a bank which is financially in a bad shape with a bigger bank in order to protect the interests of the depositors and without employing public funds in the operation; it would be quite a different thing for the Reserve Bank to undertake a nationalization operation and provide the resources for compensating the shareholders without Parliamentary scrutiny, control and approval.

Morarji then had the Bill modified.

The meetings the bankers had with Morarji and the Governor prior to the announcement of the scheme for social control had created the atmosphere for speedy implementation. Most banks with deposits of Rs 10 crore and above, and all foreign banks, had reconstituted their boards or constituted advisory boards. Indian banks with deposits of Rs 25 crore or more had appointed whole-time chairmen. On the recommendation of the Bank, which took into consideration certain practical difficulties of comparatively small banks in giving effect to some of the provisions of the Act, the government, on 1 February 1969, exempted banks with deposits of less than Rs 10 crore for a year from the provisions of Section 10A of the Act. Banks with deposits less than Rs 25 crore were exempted from the provisions of Section 10B, which related to the appointment of whole-time chairmen.

NATIONAL CREDIT COUNCIL

The National Credit Council (NCC) was said to have been fashioned on the lines of the French model in order to meet the need for aligning more closely the functioning of the banking and credit system of the country to the objectives and requirements of national economic development. The Council was constituted in terms of Government Resolution dated 1 February 1968, wherein particulars regarding the five permanent members and the names of the remaining twenty members were indicated to assist the Reserve Bank and the government in allocating credit.

The main functions of the Council were to:

- assess the demand for bank credit from various sectors of the economy;
- determine priorities for the grant of loans and advances or for investment, having regard to the availability of resources and requirements of the priority sectors, in particular agriculture, small scale industries and exports;
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- coordinate lending and investment policies as between commercial and cooperative banks and specialized agencies to ensure the optimum and efficient use of the overall resources; and
- consider other allied issues as may be referred to it by the chairman or the vice-chairman.

The first meeting of the National Credit Council was held in Bombay on 16 March 1968. It is interesting to note, in retrospect, how many invited Ministers stayed away. They included Jagannath Pahadia and K.C. Pant, who was Minister of State in the Finance Ministry. Professor D.R. Gadgil, Deputy Chairman of the Planning Commission, also could not attend the meeting as the Minister for Food and Agriculture had convened a meeting of Chief Ministers on the same day, to consider prices and other policies regarding rabi foodgrains. But he did send a note for circulation among the members, which dealt mainly with the issue of the appropriate agency for dispensing agricultural and rural credit, and the complementary roles of the commercial and cooperative banking systems in this area. He favoured the cooperative banking system, with the commercial banking structure supporting the efforts by indirectly providing funds through such means as subscribing to debentures of land development banks.

A number of background notes were prepared for the meeting. Among them, the note titled ‘Credit Planning: The Issues’ by L.K. Jha dealt with the broad principles followed by the central Bank in the past, such as asking banks to conduct their credit operations in such a way that the banking system remained healthy and the depositors’ confidence was not impaired; banks being required to see that their resources were not used for commodity hoarding and speculation; and encouraging banks to allocate a reasonable share of their resources for exports, small-scale industries, term finance for agriculture, etc. The note also pointed out that while nearly two-thirds of bank credit was being enjoyed by the industrial sector, the share of bank credit to agriculture was as low as 2 to 3 per cent. It emphasized the dearth of resources in the banking system as the major impediment in meeting the credit demands of various sectors. While specifying agriculture, small-scale industries and exports as areas requiring special attention, Jha wanted the members to identify other deserving sectors.

In his inaugural address, Morarji Desai dealt with the major issues before the NCC, such as stimulating flow of credit in adequate measure to agriculture, small-scale industry and exports; avoiding distortion by way of creation of ‘credit gaps’ in other sectors like industry and trade while accomplishing the former task; coordination among the different credit agencies, especially in the context of the controversies that were raised regarding the
roles of commercial and cooperative banks during this period; placing greater emphasis on mobilization of resources from the savings of the community rather than seeking credit from the Reserve Bank, which would ultimately add to inflationary pressures. Referring to the function of the NCC, Morarji cautioned that ‘the guidelines that we frame would have to take into account the needs of all sectors who contribute and have potentialities to contribute to our national product. This involves difficult decisions and informed judgement.’ He also indicated that a Commission would be constituted to go into suggestions from the members on specific issues. The proposed Commission, namely, the Banking Commission, was formed much later, and was chaired by R.G. Saraiya.

The ensuing general discussion followed the expected pattern, with each member propounding the strategic and economic importance of the sector represented by him, and pleading for adequate attention in the matter of credit allocation. There were, however, divergent views on the matter of branch expansion. While the commercial bankers sought further relaxations in the branch licensing policy, the cooperative sector tended to resist the banks’ increasing presence, which, according to them, was competitive. In this connection, Jha remarked:

The Reserve Bank sought to keep up pressure on banks to open branches in the rural areas by tying their branch opening in urban areas to their performance in the rural areas. It was true that the Reserve Bank did not wish commercial banks to go into small population centres where cooperative banks were well developed.

Winding up the discussions, the chairman suggested setting up a Standing Committee to go into specific issues and formulate concrete proposals for consideration by the NCC at its next meeting. Accordingly, a Standing Committee consisting of eight members was formed, with the Governor as chairman. The Bank was brought to the centrestage through the Standing Committee, which, as expected, was to drive the agenda of the NCC, keeping in view socio-political considerations.

The second meeting of the NCC was held on 24 July 1968 in New Delhi, under the chairmanship of the Deputy Prime Minister. The deliberations at the meeting mainly centred on the sector-wise estimates arrived at by the Standing Committee. The Council took note of the Committee’s suggestion that, in addition to the estimated commercial banks’ assistance, banks would be required to deploy a very large proportion of their resources in financing food procurement and allied operations, and also in financing
plantations and marketing agricultural products other than food products. This suggestion of the Committee marked the first hint of the RBI agreeing to the commercial banking system taking a more active interest in financing food procurement operations. The Council endorsed the Committee’s view that buffer stocks (as distinguished from trading stocks) should be financed out of budgetary appropriations but recognized that the banking system might have to continue to carry this responsibility for some months. On the often-discussed question of coordination and understanding between commercial and cooperative banks, Professor D.R. Gadgil, Deputy Chairman, Planning Commission, agreed with the view that where commercial banks assisted cooperatives, they should pay heed to the need for preserving the internal discipline of the cooperative movement. He also emphasized the importance of adopting an ‘area’ approach in respect of areas that were neglected by the commercial and cooperative banks.

With regard to small-scale industries, the NCC endorsed the Committee’s recommendations for allocating twice the amount of the estimated credit. The Council also felt that the estimated additional credit requirements of large and medium-sized industries could be met, and that there would be no organizational bottlenecks in the extension of such credit.

The third meeting of the NCC was held in New Delhi on 21 March 1969 and was presided over by the Deputy Prime Minister. Out of the five study group set up in the second meeting of the Council, two—viz. the Group on Deposit Mobilization by Commercial and Cooperative Banks and the Group on Credit Facilities for Road Transport Operators—had submitted their reports. The Council agreed with the recommendation of the report of the Study Group on Deposit Mobilization that it was necessary to speed up the process of opening bank branches in semi-urban and rural areas. On the question of differential interest rates as between urban and rural areas, recommended by the Study Group, the Council agreed with the Standing Committee, which had not favoured this idea on the ground that the response to a marginal upward adjustment in interest rates was not likely to be materially significant. The Council, like the Study Group, did not favour subsidization of branch expansion. The area approach suggested for branch expansion, without conferring the privilege of exclusivity to any bank, was endorsed by the Council, on its merits.

As regards the report of the Study Group on Provision of Credit Facilities for Road Transport Operators, the Council supported the view of the Standing Committee—that, rather than relying mainly on hire-purchase financing agencies and lending support to them, as suggested by the Study Group, it would be preferable for the banks themselves to engage in direct
financing of the road transport operators. It also agreed that extension of the Credit Guarantee Scheme to small-scale operators and arrangements with insurance companies for covering the risk should facilitate a far more positive role for banks in this field than in the past.

The remaining three study groups submitted their reports after the date of the third meeting of the NCC; one among them became the genesis of a path-breaking innovation in the Indian banking system, viz. the ‘Lead Bank Scheme’, about which a detailed account is given later in this chapter.

Subsequent to the third meeting of the Council, the suddenness of certain banking developments—the nationalization of fourteen major Indian banks in July 1969 and the setting up of a Banking Department in the Ministry of Finance to monitor them—quietly buried the NCC, as the scheme of social control over banks, to which the Council owed its existence, ceased to be in operation.

NATIONALIZATION

Barely four months after the third meeting of the National Credit Council, on 9 July 1969, Indira Gandhi sent a note to the Congress Working Committee through Fakhruddin Ali Ahmed, who was the Minister for Industrial Development, suggesting the nationalization of major banks. This came as a complete surprise, for the prevalent belief in Congress circles was that

2 What was most disturbing for the Reserve Bank was the impression that was created in the media that it was opposed to nationalization. This perhaps had to do with the personality of Jha himself, and with the fact that the Bank had striven hard to make a success of the social control experiment. As Vice Chairman of the National Credit Council, Jha ensured that a large number of documents were submitted on different aspects of social control. The Bank had substantial inputs in the work of the groups formed by the Council. It also helped to provide the secretariat for the Council, and to create in March 1969 a cell attached to the Banking Commission. These actions by themselves did not imply that Jha was opposed to nationalization of major Indian banks. All the oral accounts point out that while Jha did not favour bank nationalization, he did not openly articulate his personal view on the subject.

The real issue was summed up by I.G. Patel in his book, *Glimpses of Indian Economic Policy: An Insider’s View*: ‘For me, one consequence of nationalization was controversy once again about my jurisdiction and that of my department. A new banking department was created in the ministry under A. Bakshi from the RBI, an old leftist and acerbic friend of Haksar who could obviously be more relied upon to run nationalized banks than L.K. or I.G.’ (p. 137). As Patel’s quote shows, Jha was identified with forces that did not figure in the leftist groups that considered social control as an apology and a dilatory tactic to prevent the state from gaining the commanding heights of Indian finances.

After the legal tangle over nationalization was temporarily sorted out, Jha convened a
the issue had been settled in favour of social control. But Indira Gandhi had, by then, decided to confront the Syndicate in what was a bid to wrest control of the party. She needed a dramatic issue and bank nationalization fitted the bill. Accordingly, she decided to precipitate matters. Indeed, hindsight as well as oral evidence from the main dramatis personae suggest that she had already decided upon nationalization. Only the details were left to be worked out by the Finance Ministry.

Mrs Gandhi’s note pointed out:

There is a great feeling in the country regarding the nationalization of private commercial banks. We had taken a decision at an earlier AICC, but perhaps we may review it. Either we can consider the nationalization of the top five or six banks or issue directions that the resources of banks should be reserved to a larger extent for public purposes.

It also dwelt on some of the inadequacies of the scheme of social control over banks:

Even after the new policy of social control and reconstitution of boards of directors, the former industrialist chairmen of the banks still continue on the board and naturally influence the present chairmen who had previously been general managers. We may examine whether through legislation or otherwise we can prevent these men from continuing on the boards. The chief executive of the banks will not then feel obliged to the former Chairman and may be expected to take an independent line in regard to lendings.

As expected, Morarji Desai opposed the move by pointing out that the legislation on social control had been brought into force barely six months ago, and that the confidence of the public in the banking system would be

meeting of the custodians of the fourteen nationalized banks and the chairman of the State Bank of India in Bombay on 14 August 1969, to chalk out the immediate steps necessary to implement the objectives of nationalization. The meeting lasted for five hours and discussed the responsibilities of the public sector banks in the new scenario, including the fresh orientation to be given to the banking business, and ways to achieve better distribution of credit, improvement in banking services and profitability. The Governor exhorted the banks to pare their advances to big business houses and examine the scope for contracting large share advances, to aim at better distribution of credit with emphasis on small borrowers, to lay stress on banking operations in the non-urban areas, and to share the SBI’s burden of financing the Food Corporation of India’s food procurement operations.
shaken if an impression was created that the issue of nationalization was still open. He reiterated that there should be no further talk of nationalization for at least two years. He had the support of the moderates within the party, but another section, known as the ‘Young Turks’, had been persistently demanding action on issues like nationalization of banks and ceiling on incomes and urban property. They stepped up their demands.

On 10 July, nationalization was discussed in the AICC meeting. The Syndicate, which still controlled the party apparatus, underplayed the resolution on economic and social policy, stressed the ten-point programme, food supply, tenancy security, rural development, science and technology, etc., but made no reference to nationalization of private banks.

But Indira Gandhi had outmanoeuvred them. Her note sent a day earlier sidelined the official draft. She merely asked: ‘This is all right as far as it goes. The question is whether it goes far enough?’

Morarji said the objectives of social control and nationalization were the same. In his rejoinder to the specific points raised in the Prime Minister’s note, he explained:

Already the minimum that every bank had to invest in public securities was 25 per cent. Last year this rose to 29 per cent. We could also consider whether this could be raised by 5 per cent to 30 per cent. The National Credit Council which is meeting towards the end of the month will consider it and a decision can be taken.

He also referred to the fear expressed in the Prime Minister’s note about former industrialist chairmen of banks continuing to influence the present chairmen and boards of directors of companies, and said that this was being examined. Some steps had been taken to see that such influences did not operate. As a matter of fact, he said, a majority on the boards of companies now were not industrialists but representatives of agriculture, cooperatives, small industries, economists and such people who were not under the influence of industrialists. The government and the Reserve Bank were also keeping in touch to check any pressures or influence.

Y.B. Chavan, who was Home Minister then and who later became a major ally of Indira Gandhi, characterized the note as ‘the product of a restless mind’ and said ‘social control without nationalization is not possible. Similarly nationalization without social control is the greatest fraud.’ He indicated that the take-over would only be a matter of time and did not attempt to play down the fact that the party’s thinking on economic issues was coloured by political considerations.
Eventually, the resolution on economic policy remained vague about the specific issue of nationalization of banks. It did say, however, that

the note by the Prime Minister which is appended to this resolution broadly sets out the policies to be pursued and steps to be taken for the purpose of improving the performance of the economy. . . . The AICC welcomes the note and calls upon the Central and state governments to take necessary steps expeditiously to implement the various points mentioned in the note.

It had been widely expected that the Prime Minister’s note would cause a storm but, in the event, the Syndicate chose to stage a tactical retreat by virtually endorsing it without going into details.

The political tempo then began to step up. On 12 July, the Congress Parliamentary Board nominated Neelam Sanjiva Reddy, who was the Speaker, as its candidate for President. The vote was four to two, with two abstaining. This was a serious political setback for the Prime Minister, who then sponsored a rival candidate, V.V. Giri, then Vice President. Her Principal Secretary and confidant, P.N. Haksar, urged her to take some bold economic measures for the sake of her political survival, and advocated nationalization. He convinced Mrs Gandhi that the public would support her on the issue. Mrs Gandhi weighed the pros and cons of nationalization by consulting leading economists like K.N. Raj.3 G.D. Birla and J.R.D. Tata advised her against nationalization.

On 16 July, three days after the AICC session had ended, the Prime Minister surprised everyone by relieving an unwary Morarji of the Finance portfolio, and taking it over herself. The Economic Times of 17 July 1969 reported:

Indira Gandhi has no doubt sent for the Reserve Bank Governor Mr L.K. Jha, who is arriving here tomorrow. It is expected

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3 In his book, *Indira Gandhi, the 'Emergency' and Indian Democracy* (Oxford University Press, New Delhi, 2000), P.N. Dhar, former Secretary to the Prime Minister, wrote about the meeting thus: 'The other meeting, along with K.N. Raj, was at Haksar’s house. I learnt later that the second meeting was at the suggestion of the Prime Minister, who was keen to know Raj’s views on the subject. Raj was wholeheartedly for nationalization and said it would take at least six months to prepare for it and it should be done as an elaborate but clandestine exercise’ (pp. 113–14). Professor Raj later told me that there was nothing ‘clandestine’ in his espousal and the theoretical framework for advocating nationalization was given in his doctoral work on the *Monetary Policy of the Reserve Bank of India*, published in the late 1940s.
that she will consult Mr Jha on implementation of the AICC resolution on banks but sources close to her rule out the possibility of her pushing through an ordinance in a day or two in view of the nearness of the Parliament session which is to start on Monday. Mr Jha is also likely to be consulted on a statement on the new economic policy which Mrs Gandhi is reportedly planning to issue.

According to most oral accounts, Mrs Gandhi did not consult Governor Jha, knowing fully well that he was a strong advocate of social control and not in favor of nationalization. It has been recounted by some persons who held senior positions in the government then that when Mrs Gandhi called Jha to go over to New Delhi on 17 July, he went with a comprehensive note in support of social control. She is said to have told him that he could keep the note he was carrying on her table and go to the next room and help in drafting the legislation on nationalization of banks.4

We will perhaps never know exactly what happened in those three days but one thing was certain: Mrs Gandhi had decided to go ahead with immediate nationalization. A day before the announcement on 19 July, she informed I.G. Patel, Secretary, Economic Affairs, that she had taken the decision to nationalize banks on ‘political’ considerations and that he should prepare a speech within the next 72 hours. Patel is said to have offered two suggestions to Mrs Gandhi. One, that foreign banks should not be nationalized. Two, that there was no need to nationalize all banks and it would be better if only the major banks, which accounted for 85–90 per cent of the total banking business, were nationalized.

Mrs Gandhi, it seems, had apprehensions about the support she would receive from officials of the Finance Ministry and Law Ministry. From most oral accounts, it appears that she asked D.N. Ghosh, Deputy Secretary in the Finance Ministry, on 17 July, to draft the legislation within 72 hours. He was helped by R.K. Seshadri, Executive Director, who had had the experience of preparing the draft legislation in 1965 when T.T. Krishnamachari was Finance Minister. Jha oversaw the entire work relating to the drafting, which was done in the Reserve Bank of India building in Delhi.

Many think that only three or four persons were involved in the drafting. In fact, there was a secret noting in the files of the Law Ministry to the effect that S.K. Maitra, Joint Secretary, was also associated with it. Maitra

4 The oral evidence collected from a number of persons shows that the decision to nationalize a few Indian commercial banks was a political one. However, this view was not shared by left-wing economists of the day.
noted: ‘Shri Haksar told me that the Prime Minister has directed that an
Ordinance for the nationalization of certain banks should be drafted by me
immediately. He also instructed me to keep the matter completely secret
and told me that I should not disclose my movements to any one.’ He also
observed that he had the services of the personal secretary of the Governor
of the Reserve Bank and the personal assistant of I.G. Patel. He noted that
his first draft was discussed at a meeting in Haksar’s room and there were,
besides him, L.K. Jha, P.N. Haksar, A. Bakshi, I.G. Patel, B.G. Shiralkar,
R.K. Seshadri and D.N. Ghosh. The draft, it would appear from such evi-
dence, went through some changes before it was finalized.

The Banking Companies (Acquisition and Transfer of Undertakings)
Ordinance provided for ‘the acquisition and transfer of the undertakings
of certain banking companies in order to serve better the needs of develop-
ment of the economy in conformity with national policy and objectives
and for matters connected therewith or incidental thereto’. The names of
fourteen banking companies having deposits not less than Rs 50 crore as
on the last Friday of June 1969, were listed. The chairman of the existing
bank or any other person appointed by the central government, if it were
necessary to do so, would be the custodian of the corresponding new bank.

An advisory board would be appointed to aid and advise the custodian
in discharge of his duties, which would be dissolved on constitution of a
board of directors.

In the Second Schedule to the Ordinance it was indicated that the com-
ensation to be paid by the central government to each existing bank for
acquisition of the undertaking should be an amount equal to the sum total
of the value of the assets of the existing bank as on the commencement of
the Ordinance, less the sum total of the computed liabilities and obliga-
tions of the existing bank.

On 23 July, the Department of Banking Operations and Development
(DBOD) of the Reserve Bank issued a circular to all the fourteen national-
ized banks, asking them to consult the Bank before sanctioning any pro-
posal that would normally require the approval of the board of directors.
Certain other restrictions were also placed.5

5 Such as proposals that might involve the grant of a fresh loan or advance or the issue of
a guarantee, the renewal of a loan or advance granted to, or of a guarantee issued on behalf
of any party whose financial position has deteriorated since the loan or advance was granted
or last renewed or since the guarantee was issued or last renewed or the conduct of whose
account after such grant or renewal had not been satisfactory in any material respect, or the
writing off or waiver of any amount due from or grant of any concession to any such party.
These restrictions were meant to be temporary, for taking care of initial and transitional problems. They were withdrawn on 10 September and, simultaneously, the nationalized banks were asked to form internal management committees. These committees were expected to consider loan applications, investments and all other items of business that might normally be brought up before the board of directors. The banks were told that officers of the Reserve Bank would attend the weekly meetings and that a government representative might also attend.

Initially, banks with deposits of Rs 100 crore were listed for nationalization. But then it turned out that some important banks, like Dena Bank, with deposits of Rs 98 crore would be left out. So the limit was lowered to Rs 50 crore. Raghunatha Reddy, a senior Congressman, wanted that Andhra Bank too should be nationalized but its deposit level was below Rs 50 crore and it had to be left out. The criterion of Rs 50 crore deposits was itself based on the then prevalent RBI classification of banks into two categories—banks with deposits of Rs 50 crore and above, and banks having deposits of less than Rs 50 crore.

On Saturday, 19 July 1969, an Ordinance was promulgated to nationalize fourteen major banks with deposits exceeding Rs 50 crore with immediate effect. The Ordinance was signed by the Vice President, V.V. Giri, who was then also the acting President, President Zakir Hussain having died a few months earlier. In a broadcast to the nation that evening, Indira Gandhi said:

As early as December 1954, Parliament took the decision to frame our plans and policies within a socialist pattern of society. Control over the commanding heights of the economy is necessary, particularly in a poor country where it is extremely difficult to mobilize adequate resources for development and to reduce inequalities between different groups and regions.

She went on to express the ‘earnest hope’ that nationalization would mark ‘a new and more vigorous phase in the implementation of our avowed plans and policies’, and assured all sections of industry and trade that their legitimate needs for credit would be safeguarded.

But the main force driving nationalization was fully comprehended by everyone as being political, rather than economic. Indira Gandhi had won the struggle for supremacy within the Congress party and managed to wrest control, decisively and finally. The Economic Times, in its editorial the next day, summed it up nicely. It said that nationalization climaxed an unprecedented bout of power politics and feared that the psychological impact
might be rather worse because of the take-over of a larger number of banks than was feared. There was speculation that more banks were to be nationalized but the government announced that banks in the private sector would not be automatically nationalized when they achieved the level of deposits of Rs 50 crore.

Trade and industry were unhappy with nationalization but it drew support from Congressmen as well as the Communist parties and the two Socialist parties. Both Kamaraj and Atulya Ghosh, the Syndicate bosses who had opposed Mrs Gandhi tooth and nail, welcomed the measure and pointed out that it had been accepted by the AICC in principle. The Young Turks in the Congress party, led by Chandrasekhar, who had incessantly campaigned for the take-over of banks said, ‘We are extremely glad.’ Jyoti Basu, who was the Deputy Chief Minister of West Bengal, remarked that the news of acceptance of the resignation of Morarji Desai was good and the news of bank nationalization better still. The Swatantra leader C. Rajagopalachari doubted if nationalization by an ordinance was permissible under the Constitution. The former Reserve Bank Governor and Finance Minister, C.D. Deshmukh, said he favoured social control over banks. H.V.R. Iengar, another former Governor, said that nationalization was a wrong step that was not going to make a great deal of difference to the economic situation of the country. FICCI President Ramnath Poddar called it a ‘hasty step’ and said that the Prime Minister’s explanation in her broadcast failed to convince him that nationalization could achieve anything more than social control measures could not have achieved. T.T. Krishnamachari, former Finance Minister, and G.D. Birla were among those who declined to react. The All-India Bank Employees’ Association welcomed the decision. Prabhat Kar, general secretary of the Association, said the step was ‘definitely a bold one’ but much would depend upon how the nationalized sector would function. Banking circles in Bombay, who were prepared for stricter controls in the wake of the Bangalore meeting’s decision on the new economic policy, were taken by surprise.

The RBI, on its part, assured the newly nationalized banks of its unqualified support to them in the unlikely event of a transfer or withdrawal of business. Simultaneously, it told foreign banks not to take advantage of the prevailing situation. The Bank’s discussions with the custodians or local representatives of nationalized banks were initiated by B.N. Adarkar on 20 July, in the absence of Jha who was away in Delhi. The representatives of the nationalized banks were specifically told to instruct their staff that no uncertainty should be created in the minds of the customers, that business must proceed as usual and bankmen should endeavour to inspire
an atmosphere of confidence. Adarkar told the banks that they should retain their separate identities, advertise competitively for business, and that there was no objection to their going ahead with the branch expansion programme as approved by the Bank.

Monday, 21 July, was the first working day under state ownership and, according to newspaper reports, the banks functioned normally but without the suffix ‘Ltd’. The chairmen, who had been telegraphically informed by the Finance Ministry of their new roles as custodians, were considered as public servants.

Financial circles were agog with rumours that as a fall-out of bank nationalization, wide changes were on the cards in the organizational pattern and responsibilities of the Reserve Bank. In particular, the newspapers surmised that as the Governor and a majority of the Deputy Governors were said to have opposed nationalization, some important changes at the top could be expected. But nothing happened. In the last week of July 1969 Mrs Gandhi went to Bombay and addressed a huge rally of bank employees in front of the Reserve Bank of India building, which was marked by a show of great enthusiasm and support by the employees.

On 21 July, when the Lok Sabha met, it was Atal Bihari Vajpayee who raised the issue by asking about the propriety of promulgating an Ordinance of such significance when the Parliament was to meet within two days. The Deputy Speaker permitted a discussion after pointing out that any comments on the merits of the step taken would not be allowed. The Prime Minister sought to justify the haste in promulgation of the Ordinance.

The House will appreciate that in view of the very nature of the measure, and also to forestall any possibility of manipulations which may not be in public interest, it was essential to make a swift and sudden move which could only be achieved through an ordinance. The fact that speculation about Government’s intentions had assumed an acute phase in the last few days rendered it all the more necessary to act without any further loss of time, and in anticipation of the approval of Parliament, which will be sought through a Bill which Government proposes to bring during the current session.

In defence of not bringing foreign banks within the purview of the Ordinance, she stated:

So far as foreign banks are concerned they provide, by and large,
business of a specialized nature such as facilitating foreign trade and tourism. The operation of banks of one country in another, subject to the laws of the land, is mainly for such purposes and is part of an international facility. Our Indian banks also maintain their branches in many countries. It has been Government’s general policy to confine the opening of new branches of foreign banks to major port towns, where their specialized services are needed.

On the same day, Morarji Desai referred to the circumstances leading to his resignation from the Cabinet and said:

I came to the conclusion that I can no longer serve in the present Council of Ministers except at the cost of my self-respect and except as a silent spectator to methods that may endanger the basic principles of democracy on which our parliamentary system is established. I came to this conclusion because I was summarily relieved of the Finance Portfolio without even the ordinary courtesy of a prior discussion on this matter being shown to me by the Prime Minister.

The Prime Minister’s letter to Mr Desai, dated 16 July 1969, among other things, said that since Mr Desai ‘had supported the economic policy resolution at the Bangalore AICC session with reservations’, the Prime Minister did not want to strain him with the burden of implementing the economic policy, and that, therefore, she would herself take on the burden of directing finance policy.

The political battle over Mrs Gandhi’s populist measure was accompanied by a legal one. Two writ petitions were filed in the Supreme Court by Rustom Cavasjee Cooper, M.R. Masani and another person. On 22 July, the Court gave an interim stay order in respect of three matters, namely (i) that the Union of India will not appoint pending the hearing and disposal of these petitions any boards of advisers, (ii) that the Union of India will not remove the Chairmen of the various banks; and (iii) that the Union of India will not give any directions contrary to the provisions of the Banking Laws Act.

(This was actually a reference to the Banking Regulation Act.)

The Prime Minister stated in the Lok Sabha that the essential provisions of the Ordinance for nationalizing banks were not affected by the order.
The ownership of the banks continued to vest in the central government. The former boards of directors also stood dissolved. According to her, as the first direction of the Court related to appointment of advisory boards, the Reserve Bank would, in the interim, advise the banks as appropriate. As regards the second direction, she saw no reason why the order should affect the willingness or ability of chairmen/custodians to perform their duties properly. Under the third direction, she assured that the Reserve Bank would take special care to ensure that nothing was done that was contrary to the public interest or to the interests of the depositors.

The Bill to replace the Ordinance was introduced on 25 July by Govinda Menon, Minister for Law and Social Welfare, seeking acquisition and transfer of the banking companies ‘in order to serve better the needs of development of the economy in conformity with national policy and objectives’. During the clause-by-clause discussion on the Bill, the Law Minister explained that the main purpose of the banks’ take-over was to ensure credit to small industries, backward areas, farmers and progressive entrepreneurs.

During the discussion on the Bill, it was at one stage suggested that it might be referred to a Select Committee. But this did not happen. However, Mr Madhu Limaye urged for rigid fixation of percentages by statute for extending credit to various sectors of the economy. Mr Menon accepted the proposition in principle but in a flexible manner. Mr Limaye accepted Mr Menon’s assurance.

The session also witnessed severe criticism on the discernible shift in the policy approach of the government towards the banking sector vis-à-vis the role of the central Bank of the country. Initially, there was a suggestion to appoint an apex body to exercise overall supervision over the fourteen nationalized banks, which would set broad policies, apportion tasks in functional as well as geographical terms, and look after training. T.A. Pai of the Syndicate Bank was expected to be associated with the apex body. The appointment of the apex body was to be announced in the debate on the Bank Nationalization Bill. The Economic Times, in its editorial of 27 July, deplored the move on the ground that any centralized control and direction would not only thwart competition but also kill banking efficiency. It would also result in an inclination on the part of banks to look up to Delhi or the apex body and wait for detailed instructions at every turn. In the new situation, banks would have a complex machinery to contend with, namely, issue of directives from the Reserve Bank, from the Finance Ministry and from the proposed apex body. The government was urged to reconsider this idea.

The controversy was ended by Mrs Gandhi on 29 July, when she said
that the government was against setting up any monolithic machinery to control and supervise the fourteen banks that had been nationalized. Intervening in the two-day debate on the Bill to take over these banking institutions, the Prime Minister assured the House that any machinery that was set up would only provide directions on policy and not on special items or specific loans to specific parties. The government wanted to preserve the identity of these banks and also encourage healthy competition.

On 27 July 1969, the Sarvodaya Leader Jayaprakash Narayan described the take-over of banks as ‘wrong and unwarranted’, while addressing a public meeting in Rajkot. He said the step would not solve the economic ills of the country but would only enhance the power of the present rulers and bureaucrats.

Within the Reserve Bank, the first discussion on nationalization took place on 23 July, at a meeting of the Committee of the Central Board. The proceedings were not recorded except for a cryptic remark: ‘There was a brief discussion on the implications of bank nationalization ordinance.’

At the next meeting of the Committee of the Central Board, on 30 July 1969, Governor Jha pointed out that

the present intention was to preserve the individual identities of the nationalized banks. . . . While Government would be the more appropriate authority to handle issues such as compensation, labour disputes, etc., the Reserve Bank would continue to be responsible for monetary policy and ensuring compliance with its policies by the nationalized banks. The objective of nationalization was that access to credit should be open to a much wider range of people than before; credit gaps had to be identified and areas where banks could and should be involved had to be indicated.

The future set-up of the nationalized banks became clear at the meeting of the Central Board on 18 August. Jha clarified that ‘it had been decided not to have a monolithic institution and for the present the separate identities of the fourteen banks were to be preserved’. He also explained that there were practical problems in having one institution. This related to pay scales and seniority. He cited the case of the Life Insurance Corporation, which had not quite yet succeeded in sorting out these problems following the mergers of various insurance companies. There was also the problem of securing the right type of personnel to man the top positions in banks. N.A. Palkhivala, who, incidentally, was involved as an advocate in the writ petitions filed against the Ordinance and the Act, and who was also a
member of the Central Board of the Reserve Bank, welcomed the proposal to retain the identities of the banks. Competition, he felt, would be a spur to providing better services.

Towards the end of August, reports began to circulate that the Prime Minister was planning to reorganize the Finance Ministry. She was also reported to be of the view that since the nationalized banks controlled an overwhelming segment of the banking industry, banking should be handled on an exclusive basis instead by the Economic Affairs Department.

On 14 August, the Reserve Bank convened a meeting of the chairman of SBI and the custodians of the fourteen nationalized banks, to chalk out the steps necessary to implement the objectives of nationalization and to discuss the problems that the nationalized banks might face in their operations. The Governor told them that the present intention was to retain the identities of the nationalized banks so that they could compete in matters of service and explore avenues of cooperation among them for increased efficiency, greater economy, higher profitability and better overall performance. The meeting also discussed issues relating to rationalization of branch expansion and coordinated efforts in providing training facilities.

When the Banking Companies (Acquisition and Transfer of Undertakings) Bill, 1969, became an Act on 9 August, the Supreme Court’s stay order on the Ordinance was still in force, with the hearing on it fixed for 11 August. But once the Act was passed, the Supreme Court vacated the stay order. Subsequently, on the writ petitions filed against the Act, the Supreme Court issued a stay order on 8 September, saying, ‘The Court further stays the removal of any custodian during the pendency of these writ petitions and further directs that no direction will be given by the Government of India contrary to the provisions of S.35A of the Banking Regulation Act, 1949, as amended by Act 58 of 1968.’ This stay order, however, did not debar the government from appointing advisory boards, unlike the previous order.6

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6 There were many writ petitions challenging the Ordinance and the Act. But it was Dr Rustom Cavasjee Cooper, a chartered accountant from Bombay, who emerged as the initiator and main driving force behind these legal proceedings. He was director of the Central Bank of India Ltd and a shareholder in that bank. He also held shares in the Bank of Baroda, the Union Bank of India and the Bank of India. There were rumours of powerful big business/industrial houses financing his cases. So he wrote an article titled ‘Why I Moved the Supreme Court’ in the Indian Nation, published from Patna, on 25 February 1970, saying that the ‘main reason why I felt very strongly about bank nationalization was the way in which it was done. I thought that it was done with unreasonable haste, in a totalitarian manner. I also felt that in the great haste in which this was sought to be done, there was a
Operationally, meanwhile, the Finance Ministry, through the newly created Department of Banking, and the Law Ministry had taken charge of commercial banking. The Reserve Bank played a supportive and advisory role, which included collection of financial and other particulars pertaining to the newly nationalized banks, convening meetings of the bankers to chalk out the future course of action, offering comments on various aspects of developments as and when referred to it by the government, and providing clarifications on issues raised by the banks on the provisions of the Nationalization Act.

The Bank did what it was told. It also raised the issues involved in the proposed interim payment of compensation of one half of the paid-up share capital to shareholders under Section 6 of the Act. As such a step would clear violation of the sanctity of the Constitution. I have felt that not only certain political parties but even individuals in the highest places in the political sphere have started regarding the Constitution as something which can be easily played about with. My main object in taking this matter to the Supreme Court was to establish the sanctity of the Constitution, the rule of law and the fundamental rights of the individual particularly the small man and the small shareholder. . . . Charges have been made and criticisms levelled that powerful big business interests were financing my case. Insinuations were made to this effect before the Supreme Court during the hearings too. I would like to clarify that not only were there no interests financing this petition but every single person … did it for the love of the matter.’

The issue of the Supreme Court stay order came up for discussion at the meeting of the Committee of the Central Board of the Bank held on 10 September 1969. The relevant part of the minutes read: ‘There was some discussion on the implications of the Supreme Court’s stay order in the Bank Nationalization case. Director Shri Palkhiwala explained that the plaintiffs had sought the Court’s instructions that Government should not give any direction to banks contrary to the provisions of Section 35A of the Banking Regulation Act which stated that such direction could be given in terms of the banking policy, “banking policy” itself having been defined in the 1969 (amending) legislation. The Governor stated his understanding was that while banking legislation had given the Reserve Bank the power to issue directives to the banks in the public interest and in pursuance of banking policy, the Supreme Court had now stated that Government should also be subject to the same discipline in respect of issuing directives to the nationalized banks. He also pointed out that Government had even now the powers to issue directives to the Reserve Bank but whether such powers were exercised or not depended upon the nature of relationship between the Government and the Reserve Bank. Director Shri Mafatlal felt that the situation should not arise where there was dualism of authority and possibility of different interpretations by Government and the Reserve Bank as to what constituted banking policy. Shri Adarkar pointed out that the Reserve Bank under the social control system had exercised its influence through the Chairmen of banks and felt that convention should be established to retain this influence. The Reserve Bank should be the appropriate authority to interpret banking policy.’
amount to reduction in capital, it attracted the relevant constraining provisions of the Companies Act. Madhu Limaye, Socialist MP, contested that the actual amount of total compensation would work out to Rs 150 crore and not Rs 75 crore as given in the financial memorandum of the government. The issue was examined by the RBI after obtaining the necessary data pertaining to the fourteen banks and a detailed note substantiating the stand taken by the government was sent to the Department of Banking on 17 November 1969.

The Bank was actively involved in the discussions for framing the Scheme of Arrangement for nationalized banks, as provided under Section 13 of the Nationalization Act. After one such discussion, R.K. Hazari referred to a sensitive clause in the Scheme (2 January 1970) as follows:

> You might remember that we inserted a clause giving veto power to the government and the Bank nominees on the boards of directors of nationalized banks. I have thought further on this matter and feel that this clause might lead to serious misgivings about the extent of government control over these banks. There is no such clause in the State Bank Act and comparable provisions in respect of government companies have been deleted in recent years or are proposed to be deleted. I wonder if you would like to consider the matter.

Another issue that needed to be sorted out was the powers of the custodians in the absence of a board. These had been left undefined and the matter needed to be rectified. Public interest required that some of the more important transactions of the banks were put through only with prior approval of the Reserve Bank. So directions were issued requiring the custodians to seek prior approval of the Bank before putting through certain transactions.\(^7\)

On 10 February 1970, the Supreme Court upheld the legislative competence of Parliament in the matter of acquisition of the banking companies but struck down the nationalization. Firstly, it said, there had been hostile discrimination against the fourteen banking companies in so far as they

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\(^7\) These covered the grant of advances in excess of Rs 25 lakh (with suitable exemptions to ensure that financing of the priority sector was not affected); investments in excess of Rs 1 lakh in shares and debentures of joint stock companies or advances thereagainst above Rs 5 lakh; appointment and extension of service of senior executives, expenditure on land/buildings above specified amounts as also making provisions and appropriations out of profit.
had been debarred from carrying on banking business when other banks were permitted to do so. Secondly, it said that the principles and methods laid down in the Act for determining the quantum of compensation were invalid. And since these provisions were not severable from the main Act, the entire Act was struck down.

However, as against the majority judgement, Justice A.N. Ray gave a dissenting judgement in which he observed:

The only way in which the exercise of power by the President can be challenged is by establishing bad faith or malafide and corrupt motive. Bad faith will destroy any action. Such bad faith will be a matter to be established by a party propounding bad faith. He should affirm the state of facts. He is not only to allege the same but also to prove it. In the present case there is no allegation of malafide … the petitions fail and are dismissed.

In response to the judgement, and on the same day, the DBOD issued a directive under Section 35A of the Banking Regulation Act, 1949, which was identical in content to the one issued on 22 January, except that the present directive was addressed to the chairmen of the banking companies and not the custodians. Another note submitted by the chief officer of the DBOD on 10 February stated:

The Supreme Court has today struck down the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1969. From the reports available to us, it appears that the Act has been held void mainly on the grounds that it is discriminatory against the fourteen banks which had been nationalized and that the compensation proposed to be paid by government was not fair compensation. As a result of the Supreme Court’s decision, the undertakings of the banks have reverted to the corresponding banks. At the moment, we are not aware of the government’s intention as to the future course of action to be taken in regard to these and other banks. There is, therefore, uncertainty in the banking system and in the circumstances it is necessary that in the public interest and in order to protect the interests of the depositing public, the Reserve Bank should appoint its officers as directors of these fourteen banks, as also of other banks to which we have been sending observers in terms of section 36(1)(d)(ii) of the Banking Regulation Act, 1949.

This was approved by the Governor on the same day and action was
initiated accordingly. A resolution to this effect was passed by the Committee of the Central Board on 11 February.

During the hearing of the writ petitions against the Ordinance and the subsequent Act, officials of the government and the Reserve Bank had attended the proceedings and studied the arguments to ensure that, in case the Ordinance/Act was struck down, the government could issue a new Ordinance keeping in view the observations of the Supreme Court. Eventually, the government issued a fresh Ordinance on 14 February that did not contain the offending provisions of the earlier Act. Under this Ordinance, the government again took over the undertakings of each of these banks with effect from the original date, i.e. 19 July 1969. This Ordinance, unlike the void Act, did not set out any principles for the determination of compensation to be paid to each of the fourteen limited companies whose undertakings were acquired but fixed a specific amount of compensation to each of the nationalized banks, aggregating Rs 8,740 lakh, to be paid within 60 days from the date the banking company applied for it. The banking companies were given three options or any mix of these: in the form of cash, ten-year central government securities at par carrying 4.5 per cent interest per annum, and thirty-year central government securities at par carrying interest at 5.5 per cent per annum. Allahabad Bank and Indian Overseas Bank opted for payment of the entire amount of compensation in cash, ten banks opted for payment entirely in the form of securities, and the remaining two banks opted for payment of compensation partly in cash and partly in government securities. In the case of the first two banks, cash payments were made in instalments, while in the case of the other banks the claims were settled as per their options.

The Banking Companies (Acquisition and Transfer of Undertakings) Bill, 1970, to replace the Ordinance issued on 14 February 1970, was introduced in Parliament on 27 February and was passed without any amendment by both the Houses towards the end of March 1970. The Bill received the assent of the President on 31 March 1970.

The international reaction to bank nationalization in India, as officially recorded in the Reserve Bank, appeared to be passive. A rather nondescript remark on the subject made by Jha, while referring to ‘his impressions of views abroad on India’, was recorded by Secretary M. Narasimham in the summary of discussions of the Committee meeting held on 22 October 1969: ‘The various people he met did not hold any strong views on bank nationalization.’ The narration went on to add that from the point of view of international observers, the success of the country in food production had more or less overshadowed all other contemporary developments: ‘the
picture of a hungry India depending upon the world charity for its essential food supplies had now given way to a new image of an India able to make significant progress on the agricultural front.’

The first phase of nationalization and its aftermath, as revisited by I.G. Patel, offers an interesting picture.

By all accounts, the nationalization of major banks was a great success initially. Apart from the political dividends for Mrs Gandhi, it greatly increased popular confidence in the banking system and thus increased the mobilization of private savings through banks. The savings so mobilized were also used now for supporting public borrowing as well as for meeting hitherto neglected genuine credit needs. The rot started with the Emergency and what political opportunism started was compounded by bank staff of all grades. With nationalization came the entry of national unions with allegiance to different political parties, mostly the Congress and the Left. Shielded by political support the bank staff proceeded to create for themselves a vast superstructure of perks and privileges under which they could define and limit work, enforce overstaffing and generally encourage indiscipline and incompetence without any fear of being held accountable. Merit went by the board as did customer service; and seniority and closeness to political power held sway.

In 1980, after Indira Gandhi was voted back to power—she had been defeated in the general election of 1977—there was a second round of nationalization. Six banks were taken over, but this was a non-event in comparison with the heightened political drama and legal controversies that had accompanied the first nationalization. Its most important distinguishing feature, perhaps, was that while the Reserve Bank had not been party to the 1969 decision and Governor Jha, as later chronicled by M. Narasimham, ‘was clearly unhappy with the decision’, in 1980, the initiative came from I.G. Patel, the Governor of RBI. The records in the Bank are not suggestive of any formal correspondence between the Bank and the government on this subject, nor of any discussion having taken place at the meetings of the Central Board of the Bank.

However, I.G. Patel’s memoirs provide an insight into the whole affair. ‘Such is the irony of life’, he writes,

that one of the first steps I had to recommend to Mrs Gandhi was that she should nationalize another swathe of private banks.
The Reserve Bank had the responsibility to supervise private banks and to ensure their compliance with social control norms as well as with law. Several small private banks had now grown to respectable size and it was not easy to control their activities in practice. Some of them, like the Punjab and Sind Bank and the Vijaya Bank, had become the personal fiefdoms of individuals who disregarded all rules and advice with impunity. They, with their shady dealings, were offering unfair competition to the nationalized banks. I decided that the only practical way to tackle the problem was to nationalize the banks which had now reached the cut-off point of the 1969 Act. Mrs Gandhi readily accepted the advice—going against her promise of no new wave of nationalization, strictly speaking.

Patel added that the Prime Minister had ‘no appetite’ for nationalization then and that this particular initiative for the second phase of bank nationalization had come entirely from him as Governor of the Reserve Bank.

The Banking Companies (Acquisition and Transfer of Undertakings) Ordinance, 1980, was issued on 15 April 1980, under the signature of N. Sanjiva Reddy, President of India, nationalizing six more commercial banks. These were Andhra Bank, Corporation Bank, New Bank of India, Oriental Bank of Commerce, Punjab and Sind Bank, and Vijaya Bank. Their deposits in India, as shown in their returns on 14 March 1980, amounted to not less than Rs 200 crore. The purpose of the nationalization was indicated as ‘to further control the heights of the economy, to meet progressively and serve better the needs of the development of the economy, and to promote the welfare of the people in conformity with the policy of the State’.

It was explained that, as on the previous occasion, branches of foreign banks incorporated outside India would remain unaffected by the proposed measure because it was necessary to maintain the status quo in the interest of the future of Indian banking abroad. Further, the operations of these banks were limited mainly to port towns and Delhi and largely catered to specialized areas like foreign trade, tourism, etc., and the total deposits of foreign banks in India was less than 4 per cent of the aggregate deposits of all scheduled commercial banks. It was also estimated that with the inclusion of these six banks, the total deposits of public sector banks would be around 91 per cent of the deposits of all scheduled commercial banks.

Indira Gandhi claimed at a news conference that the nationalization of
the six banks was meant to help the weaker sections of society. The general opinion among banking circles was that the take-over of the banks was no more than a further step in the government’s action of eleven years ago, when it had wanted the large banks to ‘fall in line’ with its goal of attaining national objectives; in that sense, the decision was seen as long overdue. It was also noted that professionalization in the management of private sector banks had not attained the same heights as in the public sector banks, and that there had been recently a ‘whiff of complaints’ against some of the private sector banks of interlocking advances that had been made against the other banks too, before nationalization. The Federation of Indian Chambers of Commerce and Industry (FICCI), in a press release, was highly critical of the government’s action, which it described as a bad and sad decision. Various associations of bank employees, however, welcomed the step as necessary on account of the several malpractices rampant in these banks, and, more importantly, the harassment of their employees and victimization of trade union activities. The All-India Confederation of Bank Officers Organization said that the decision to nationalize should have been taken earlier because the allegations of mismanagement against most of these banks had been on record for over five years.

*The Economic Times* wrote, on 17 April, that there was no merit in the second round of bank nationalization. It observed that, with no ideology in place, save for the shopworn Twenty-Point Programme, Mrs Gandhi’s government, in its search for character, had sought to play the one card available to regimes the world over for whipping up popularity. It sarcastically commented that what followed from the logic underlying the latest spell of nationalization was that growth and public welfare would be increased manifold by taking over the minority shares held by a few individuals in the SBI.

The draft Bill to replace the Ordinance was referred to the Reserve Bank for suggestions in the last week of April. The necessary notifications for converting the Ordinance into a Bill were communicated to the government on 3 May. The Banking Companies (Acquisition and Transfer of Undertakings) Bill, 1980, was introduced in the Lok Sabha by the Finance Minister, R. Venkataraman, on 12 June. In sharp contrast to the heated exchanges witnessed a decade ago while considering an identical Bill, the discussions on the 1980 Bill were brief. While answering a specific query as to why a Rs 200-crore norm had been fixed for the second phase of nationalization, the Minister explained that the norm enabled the government to practically control 91 per cent of the entire deposits of the country, that it would be difficult to take over all the banks at the same time for national-
ization and that the government was not committed to such a principle. He added that when a bank which had Rs 200 crore of demand and time liabilities was nationalized, hypothetically, if there was another bank with Rs 199 crore of deposits, then the Act was likely to be struck down on the ground of improper discrimination. In the extant instance, the next private bank had only about Rs 150 crore of deposits.

The Bill was passed by both Houses of Parliament in June 1980 and it received the President’s assent on 11 July 1980.

Mr Inder Malhotra wrote:

Mrs Gandhi’s close friend, Pupul Jayakar, complimented her on the excellent timing of her decision to nationalize the banks. In a revealing reply, Mrs Gandhi said that the timing was not chosen by her but by her adversaries. ‘They drove me to the wall and left me with no other option.’