

## AUTARKY OF RESERVE BANK OF INDIA IN INDIA

Written by **Navita Aggarwal**

Assistant Professor, HNLU Raipur

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### **Abstract:**

*Reserve Bank as guardian of Indian Banking sector is facing tough time from executive or if put forth bluntly government at centre as well as from Judiciary. The stringent and evasive directions to RBI over monetary matters from Government at centre and consequent resignation of top executives from RBI kicks off a debate where it is imperative to assess as to what all this institution: Reserve Bank of India is all about.*

*The Banking structure in India is distributed among nationalised Banks, Private Banks, scheduled, non-scheduled banks and foreign banks. A laymen approach has always look upon Banks as a institution sponsored by Governments which give loans and keep deposits. However, this approach has evolved and new era in form of mobile banking, internet banking, cross selling etc has ejaculated. With new facets, the risk in banking sector has increased two or three folds.*

*The writer in this work, tried to analyse the position of Reserve Bank of India vis- a- vis the banks and government with a legal lens.*

### **INTRODUCTION:**

Reserve Bank of India<sup>1</sup> Act is of year 1934. Prior to establishment of RBI, the functions of a central bank were virtually carried by the Imperial Bank of India. RBI, when the idea was conceived held as a private owned bank without major government ownership.<sup>2</sup>

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<sup>1</sup> Hereinafter referred as RBI

<sup>2</sup> <https://www.orfonline.org/research/rbi-versus-the-government-independence-and-accountability-in-a-democracy-46085/>

After independence, the government passed Reserve Bank (Transfer to Public Ownership) Act, 1948<sup>3</sup> and took over RBI from private shareholders after paying compensation.<sup>4</sup> In other words, RBI was nationalized in 1949. The preamble of this said Act: “An Act to bring the share capital of the Reserve Bank of India into public ownership”<sup>5</sup> The question which call for an appropriate reply is whether after nationalization RBI is owned by Government of India or what do we mean by “Public Ownership”. Consequently Is RBI a Government Bank?.

Both question are inter connected and may legitimately be answered when the history of RBI Act of 1934 is read with the debates which throw some rays of light over the purpose and rationale of having a regulator over Banks and referred as the “Central Bank”. The writer starts with a brief history of RBI leading to present situation followed by a legal analysis and wrapping with a conclusion.

## **TRACES OF HISTORY**

The History of RBI can be traced from the time when Hilton Young commission was appointed in August 1925 to examine and report on the Indian exchange and currency system and practice ; to consider whether any modifications are desirable in the interests of India ; and to make recommendations ‘.<sup>6</sup> The question of the need for a central or State bank was thus not referred to the said commission.

The Commission, however, examined this matter and in its Report, submitted in July 1926, strongly recommended the establishment of a central bank. The bank was to be called the ‘Reserve Bank of India’, and all central banking functions were to be entrusted to it. Pointing out the ‘inherent weakness’ of the Indian system, where the control of currency and credit was in the hands of two different authorities, the Commission remarked: The Government controls the currency and the credit situation is controlled, as far as it is controlled at all, by the Imperial Bank. With divided control, there is likelihood of divided counsels and failure to co-ordinate.

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<sup>3</sup> <https://indiankanoon.org/doc/1353429/>

<sup>4</sup> <https://www.gktoday.in/gk/history-of-reserve-bank-of-india/>

<sup>5</sup> Refer to the preamble of the Reserve Bank (Transfer to Public Ownership) Act, 1948

<sup>6</sup> Aditya Mukherjee, “Controversy over Formation of Reserve Bank of India, 1927-35”, *Economic and Political Weekly*, Vol. 27, No. 5 (Feb. 1, 1992), pp. 229-234, Pg 1

The only certain way to secure coordination is to concentrate the controls in one hand. In other countries the single controlling hand is that of a Central Bank. For development of banking also, the Commission considered a central banking system with facilities of rediscounting as essential because it felt that only then commercial banks could treat commercial bills held by them as their secondary reserves, capable of immediate realisation.<sup>7</sup>

The report of commission is important from two focal points:

1. Constitution and Control of the Bank
2. Core functions of Bank

While tracing history, it may be divided in two phases. The first phase began with Hilton Young Commission and introduction of Reserve Bank Bill in the Central Legislative Assembly in 1927 by Basil Blackett, the finance member. The second phase is associated with the Round Table Conferences and culminated with the discussions on the RBI Bill.<sup>8</sup>

While discussing, the constitution, two options: state owned Bank or a shareholders Bank were available. It was decided to set up the bank as a private corporation, but under the patronage of the East India Company. The Company authorities did not want to establish a bank 'on their own immediate account' for two reasons, these being (i) that the official emoluments arising out of such a system in the hands of the Company's agents would far exceed the moderate profits of the bank and (ii) that 'the want of time and ability in the Government, either to superintend or control so complicated and extensive a business' was an 'insuperable' objection.<sup>9</sup> In the main the controversy on proposals for a central bank related to the questions of ownership -State versus private ownership -and management of such a bank. The interesting thing desired was 'independence' of the bank from Government control in its day-to-day working. The difference in the approach lies on the question of selection of board where Indian leaders were against private person participation and asked for legislative interference. These arrangements were not acceptable to the British Government in India, who preferred to keep

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<sup>7</sup> <https://rbidocs.rbi.org.in/rdocs/content/PDFs/89630.pdf>

<sup>8</sup> Aditya Mukherjee, "Controversy over Formation of Reserve Bank of India, 1927-35", *Economic and Political Weekly*, Vol. 27, No. 5 (Feb. 1, 1992), pp. 229-234, Pg 1

<sup>9</sup> <https://rbidocs.rbi.org.in/rdocs/content/PDFs/89634.pdf>, Pg 3

the Legislature out of the scheme and retain residuary powers with the Governor-General. In the end, this view prevailed.<sup>10</sup>

The whole discussion on the Bill was represented by two groups: state and capitalist. However, the first Reserve Bank Bill was abandoned for the time being on abandoned, mainly on the ground that the legislature refused to "accept provisions which in the eyes of the government would protect the Bank from political influence".<sup>11</sup> The question of "political influence" was discussed in the meetings and very worth noting observation was made by Sri PurshottamDas Thakurdas a member of Hilton Young Commission, "political influence should be avoided in every country which has full democratize institutions, because there "the party in power has all the patronage at its command and therefore anything which may have open political influence means the influence of the party..." In India, however, "it is the government that has the patronage; it is the government that can exercise political influence. The only difference is that (they) will not call that 'political' ". The 'boot' was, therefore, clearly 'on the other leg', i e, rather than guard the bank against the influence of the non- official benches of the legislature there was need to guard it against the influence of 'executive', the government.<sup>12</sup>

Another person worth citing here is John Maynard Keynes<sup>13</sup> who played an instrumental role in formation of RBI and carving out its functions. He proposed the amalgamation of three Presidency Banks of presidency towns: Madras, Calcutta and Bombay and Form an Imperial Bank of India which will be State Bank. On the question of government shareholding he unambiguously recommended that Government subscription to the capital, he considered, was not necessary, as it would 'complicate rather than simplify the relations between the Government and the shareholders'. On questions of Supreme Court e vested all the powers with Central Board.<sup>14</sup> To quote:

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<sup>10</sup> <https://rbidocs.rbi.org.in/rdocs/content/PDFs/89634.pdf>, pg 4

<sup>11</sup> *Supra footnote 5*, India Office note on Reserve Bank, November 30, 1932, Finance Department (L/FV5/191. IOR.

<sup>12</sup> <https://rbidocs.rbi.org.in/rdocs/content/PDFs/89634.pdf>, Pg 5

<sup>13</sup> He was a British economist whose ideas fundamentally changed the theory and practice of macroeconomics and the economic policies of governments. He built on and greatly refined earlier work on the causes of business cycles and was one of the most influential economists of the 20th century. Widely considered the founder of modern macroeconomics, his ideas are the basis for the school of thought known as Keynesian economics and its various offshoots. In Indian Context, je was a member of The Chamberlain Commission's with Mr. L. Abrahams

<sup>14</sup> <https://rbidocs.rbi.org.in/rdocs/content/PDFs/89634.pdf>, Pg 23

*It cannot be maintained that some responsibility for banking, seeing that it is in fact undertaken by nearly all civilised Governments, is inherently undesirable. The undesirable features in the Government's present degree of responsibility for these things in India are rather due to the lack of suitable machinery. It seems clear that Government cannot entrust any of its existing duties to private hands. It has also become plain that, whether a State Bank is established or not, Government, so far from relinquishing old duties, must bend itself to new ones. The choice lies between a good deal of responsibility without thoroughly satisfactory machinery for the discharge of it; and a little more responsibility with such a machinery. The balance of advantage is with the second alternative. The Secretary of State would be behind the Bank, but his authority would only come into play on rare and important occasions. On important changes of policy and on alterations of clauses in the Bank Act, the Secretary of State would have the last word and with it the responsibility . . . . But for the ordinary daily work of the Bank he would necessarily disclaim responsibility to a far completer extent than is at present possible in the case of any of the financial business now conducted by the Government. The Bank, though ultimately dependent on the State, would lie altogether outside the ordinary Government machine; and its executive officers would be free, on the one hand, from the administrative interference of Government and free also, on the other hand, from too much pressure on the part of the shareholders, in cases where this might run counter to the general interest.*

Among the various functions of this Bank, the Bank was allowed to do commercial business apart from acting as a Banker to the government and Bank to other Banks.

The history of Reserve Bank can be concluded on this note that this institution was considered independent and devoid of outside interference especially in form of executive and every single endeavour was made to make this institution well capable to handle itself after making Central Board an effective tool. Hence, the RBI act of 1934 gives the ultimate power to Central Board.<sup>15</sup>

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<sup>15</sup> Section 8 of RBI Act

Composition of the Central Board, and term of office of Directors.

(1) The Central Board shall consist of the following Directors, namely:-

(a) a Governor and 8[not more than four Deputy Governors to be appointed by the Central Government

(b) four Directors to be nominated by the Central Government, one from each of the four Local Boards as constituted by section 9;

## POST INDEPENDENCE ERA

After independence, the first legislation which reformed Reserve Bank of India was The Reserve Bank (Transfer To Public Ownership) Act, 1948 with effect from 23rd September 1948. It is a small legislation of 7 seven sections and the important section for our discussion is Section 3 which deals with Transfer of Bank Shares

Transfer of Bank shares.-

(1) On the appointed day--

(a) all shares in the capital of the Bank shall by virtue of this Act be deemed to be transferred free of all trusts, liabilities and encumbrances to the Central Government, and

(b) as full compensation therefore, the Central Government shall issue to every person who, immediately before the appointed day, is registered as the holder of any such shares, an amount calculated at the rate of one hundred and eighteen rupees and ten annas per share, in promissory notes of the Central Government bearing interest at the rate of three per centum per annum repayable at par on such date as may be specified in this behalf by the Central Government:

Provided that where the amount so calculated is not an exact multiple of one hundred rupees the amount in excess of the nearest lower multiple of one hundred rupees shall be paid by cheque drawn on the Bank:

Provided further that in respect of any share obtained at par from the Central Government by any Director of the Bank in pursuance of sub- section (8) of section 4 of the principal Act as in force immediately before the appointed day, the said amount shall be calculated at the rate of one hundred rupees per share.

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- (c) [ten] Directors to be nominated by the Central Government; and  
(d) one Government official to be nominated by the Central Government

(2) Notwithstanding the transfer of shares effected by this section any shareholder who, immediately before the appointed day, is entitled to payment of dividend on the shares held by him shall be entitled to receive from the Bank--

(a) all dividends accruing due on his shares in respect of the year ending on the 30th day of June, 1948 , or any preceding year remaining unpaid on the appointed day;

(b) dividends calculated at the rate of four rupees per annum per share in respect of the period from the 1st day of July, 1948 , to the appointed day.

The first clause of this section transferred the capital of the Bank and by virtue of this Act, capital is deemed to be of Central Government which is free of any liability or encumbrance of any kind. Thus the legislature in exercise of its power vests the shareholding of RBI in hands of central government. Thus in other words, RBI was nationalized by virtue of this Act.

### **RECENT SPAT BETWEEN RBI AND GOVERNMENT AT CENTRE**

The recent tussle between the two, resignations of RBI Governors: Sri Raghuram Rajan and Sri Urjit Patel, arguments of autonomy and supremacy hit the headlines in newspapers and a hot topic on social media. What is the actual issue?

Differences between the two over easing lending norms, for certain sectors and the appropriate size of reserves to be maintained by this central Bank, Prompt corrective Action by central Bank for regulating weak public sector Banks<sup>16</sup> , easing loans to Medium Small Enterprises(SMEs)<sup>17</sup>, are the main issues<sup>18</sup>

The government justified its brook on ground of Section 7 of RBI Act<sup>19</sup> and warrants the situation contending that independence of the Central Bank is a western concept and RBI

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<sup>16</sup> The government wants the RBI to exempt power companies under the prompt corrective action or PCA framework, which outlines triggers for declaring a loan account as stressed or non-performing asset. <https://www.ndtv.com/india-news/rbi-vs-government-10-things-to-know-1941159>

<sup>17</sup> The government has asked the central bank, reportedly using the privilege provided under Section 7 of the RBI Act, to ease its hold on the reserves for providing liquidity to the market. It has also sought for some constraints on banks for loans to small and medium enterprises or SMEs to be removed,

<sup>18</sup> <https://economictimes.indiatimes.com/news/economy/policy/rbi-vs-govt-in-2018-a-husband-wife-relation-that-turned-stormy/articleshow/67333041.cms> (accessed on 2-05-2019)

<sup>19</sup> Section 7:Management.

must act and work in sync with the directions issued by Central Government as the Central Government owns RBI.<sup>20</sup>

### **JUDICIAL RESPONSE TO THI SPAT**

The Allahabad High Court in case of Independent Power Producers Association of India Vs. Union of India & Ors on 27.08.2018 through Hon'ble Dilip B. Bhosale, Chief Justice & Hon'ble Yashwant Varma, J. tried to resolve the conflict. The RBI circular was challenged through Writ Petition where RBI in exercise of its powers given under section 35AA of Banking Regulation Act, directed Banks over initiating Insolvency proceedings in specified cases. The Circular is applicable on all kinds of industries and this was challenged and countered that thermal industry should be out of the purview of these guidelines.

The High Court held “RBI is essentially a monetary and fiscal regulator. It does not appear to be specifically charged with the function of framing sectoral resurrection measures or to fix incipient or seething problems faced by a particular industry. It would appear that it is essentially obliged to take a macro look at the financial sector and the fiscal condition of the country as a whole. If it be the stand of the Union that a particular industry merits independent consideration in light of its own peculiar facts, then it is for it to convey and advise the RBI accordingly leaving it open to the central bank to evaluate and consider whether any modulation is merited and justified.”

The matter was appealed before Supreme Court<sup>21</sup> and the Hon'ble court rested the matter after striking down the said circular. The court while deciding quoted Section 45 L of RBI

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(1) The Central Government may from time to time give such directions to the Bank as it may, after consultation with the Governor of the Bank, consider necessary in the public interest.

(2) Subject to any such directions, the general superintendence and direction of the affairs and business of the Bank shall be entrusted to a Central Board of Directors which may exercise all powers and do all acts and things which may be exercised or done by the Bank. 6[(3) Save as otherwise provided in regulations made by the Central Board, the Governor and in his absence the Deputy Governor nominated by him in this behalf, shall also have powers of general superintendence and direction of the affairs and the business of the Bank, and may exercise all powers and do all acts and things which may be exercised or done by the Bank.

<sup>20</sup> <https://www.ndtv.com/india-news/rbi-vs-government-10-things-to-know-1941159>

<sup>21</sup> Dharani Sugars And Chemicals Ltd. Vs Union Of India & Ors., WP (CIVIL) NO.1399 OF 2018 decided on 02.04.2019 by RF Nariman J



Act<sup>22</sup> and held that the RBI has blatantly disobeyed the law laid down under Section 45L(3) of the Act. To quote:

“Further, it is clear that the impugned circular applies to banking and non-banking institutions alike, as banking and non-banking institutions are often in a joint lenders’ forum which jointly lend sums of money to debtors. Such non-banking financial institutions are, therefore, inseparable from banking institutions insofar as the application of the impugned circular is concerned. It is very difficult to segregate the non-banking financial institutions from banks so as to make the circular applicable to them even if it is ultra vires insofar as banks are concerned. For these reasons also, the impugned circular will have to be declared as ultra vires as a whole, and be declared to be of no effect in law. Consequently, all actions taken under the said circular, including actions by which the Insolvency Code has been triggered must fall along with the said circular. As a result, all cases in which debtors have been proceeded against by financial creditors under Section 7 of the Insolvency Code, only because of the operation of the impugned circular will be proceedings which, being faulted at the very inception, are declared to be non-est.”

### **CRITICAL ANALYSIS**

A very judicious and succinct idea adopted by the Hon’ble Supreme court and laid down In Para 17 of the said judgment says that the reason and the objects of any law can be of

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<sup>22</sup> 45L. Power of Bank to call for information from financial institutions and to give directions.

(1) If the Bank is satisfied that for the purpose of enabling it to regulate the credit system of the country to its advantage it is necessary so to do; it may—

(a) require financial institutions either generally or any group of financial institutions or financial institution in particular, to furnish to the Bank in such form, at such intervals and within such time, such statements, information or particulars relating to the business of such financial institutions or institution, as may be specified by the Bank by general or special order.

(b) give to such institutions either generally or to any such institution in particular, directions relating to the conduct of business by them or by it as financial institutions or institution.

(2) Without prejudice to the generality of the power vested in the Bank under clause (a) of sub-section (1), the statements, information or particulars to be furnished by a financial institution may relate to all or any of the following matters, namely, the paid-up capital, reserves or other liabilities, the investments whether in Government securities or otherwise, the persons to whom, and the purposes and periods for which, finance is provided and the terms and conditions, including the rates of interest, on which it is provided.

(3) In issuing directions to any financial institution under clause (b) of subsection (1), the Bank shall have due regard to the conditions in which, and the objects for which, the institution has been established, its statutory responsibilities, if any, and the effect the business of such financial institution is likely to have on trends in the money and capital markets.

help while interpreting any law which has any ambiguity. The writer quotes Justice Nariman who said “When it comes to lack of any guidelines by which the power given to the RBI is to be exercised, it is clear from a catena of judgments that such guidance can be obtained not only from the Statement of Objects and Reasons and the Preamble to the Act, but also from its provisions.”

As a legal scholar, I would like to move one step ahead and take legislative debates also in consideration which took place while promulgating the said legislation to settle out the object of the act and further its provisions. Now, if we take the history and the said statement in consideration, the preamble of RBI Act says (relevant portion) “An Act to constitute a Reserve Bank of India. Whereas it is expedient to constitute a Reserve Bank for India to regulate the issue of Bank notes and the keeping of reserves with a view to securing monetary stability in India and generally to operate the currency and credit system of the country to its advantage; And whereas in the present disorganisation of the monetary systems of the world it is not possible to determine what will be suitable as a permanent basis for the Indian monetary system”.

Hence, it can be concluded that Reserve Bank of India is formed to stabilize monetary system of country. If we look down to the history then, it put down a clear image that this institution was desired to be free from any interference of any kind and thus autonomous. The kind of interference by Judiciary makes the Judiciary as the supreme which is against the idea of the founders of RBI. Another, reason in favour of vesting the confidence over the decisions of RBI with regard to the monetary system of India is that the institution have experts in the relevant financial field who understands the technical aspect of monetary system and carries a far sighted approach. Accordingly, it is logical and reasonable if we rely on their wisdom rather than judicial acumen.

Now, another question which comes as to why the Supreme Court dicta is given the highest precedence. One reason is because of constitutional mandate enshrined in Article 141 which makes Supreme Court judgment as law of land. Another, reason may be we as people owe respect to the great institution since we believe that it is leading the law in a right direction.

As far as the control of Executive or Government over RBI is concerned, the Government contends its ownership over RBI on the foundation of Reserve Bank (Transfer to Public Ownership) Act, 1948. If we look at the preamble of the said Act, it uses the word “public ownership” which does not imply Government ownership. A counter argument of this idea is that if not this then what one should understand by “public ownership” since it is a settled principle that whatever does not belong to any bloke certainly is of Government. The insidious answer is that why one intends to make anyone owner of RBI and from where this “control and supremacy” is originated. The Reserve Bank of India provides a support to the Government which requires its independence to work up to its best. The Indian Judiciary also, has escaped from the issue of autonomy or supremacy of central government over RBI very modishly. The Supreme Court has missed out a good chance of interpreting executive power<sup>23</sup>

## **CONCLUSION**

Reserve Bank of India as an institution has its own legacy that ultimately it is designed for stabilizing economy. It has got its identity through a statute and the writer strongly opines that a statutory body does not need ownership. RBI is the controller, regulators and can handle the financial and monetary issues independently however, the door of recommendation, advice and yielding discussion is always open as the reverse side of the coin should be taken care.

The writer propose to extend the principle of separation of power with a cautious warning that if the interference continues to be this rampant from all the different corners: executive or judiciary then India as a developing economy may face wrath of destabilized economy with no clue as to how to revamp it.

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<sup>23</sup> Viral Acharya warned that "the risks of undermining the central bank's independence are potentially catastrophic". "Governments that do not respect central bank independence will sooner or later incur the wrath of financial markets, ignite economic fire, and come to rue the day they undermined an important regulatory institution," he said.