NABARD and RBI
A 30-Year Legacy Being Upturned

The effort to edge out the Reserve Bank of India from the National Bank for Agriculture and Rural Development’s shareholding does not bode well for the future of agricultural and rural credit in the country. This is particularly so, if the past experience with the Industrial Development Bank of India and the Unit Trust of India is any guide.

The finance minister’s budget speech earlier this year contained a seemingly innocuous statement, To take forward the process of financial sector legislative reforms, the government would move the following bills in the budget session of the parliament: the Micro Finance Institutions (Development and Regulation) Bill, 2012; the National Housing Bank (Amendment) Bill, 2012; the Small Industries Development Bank of India (Amendment) Bill, 2012; the National Bank for Agriculture and Rural Development (Amendment) Bill 2012; Regional Rural Banks (Amendment) Bill, 2012; Indian Stamp (Amendment) Bill 2012 and Public Debt Management Agency of India Bill, 2012 (GOI 2012).

While there is a rationale for bringing each bill before Parliament, one is perplexed why amendments are being proposed to the National Bank for Agriculture and Rural Development (NABARD) Act, 1981. The Act in its present form has not hindered the functioning of the institution and has given it enough manoeuvrability to expand the scope of its activities and facilitate new innovations and developmental interventions. The amendments to the Act carried out in 2000 have cleared whatever technical difficulties or obstacles the institution might have faced in its functioning. The only plausible reason for the proposed amendment is easing out the Reserve Bank of India (RBI) from the shareholding of NABARD to make it a wholly government-owned entity. This step would alter the basic structure of the institution as envisaged by the Sivaraman Committee that conceived and recommended its establishment and the vision the government of the day, led by Indira Gandhi, had for it.

In striking contrast to other central banks, the RBI, by its statute, has been given an important role in the sphere of rural credit because of the predominantly agricultural character of the Indian economy and the need to expand and coordinate the credit facilities available to the agricultural sector. The RBI Act laid down that the bank would create a special agricultural credit department to maintain an expert staff to study all questions related to agricultural credit and be available for consultation by the central government, state governments, state cooperative banks and other banking organisations. It was also to coordinate the operations of the bank in connection with agricultural credit and its relations with state cooperative banks and any other banks or organisations engaged in the business of agricultural credit (RBI 1934). The agricultural credit department was one of the first departments of the RBI. After the recommendations of the Informal Conference (of 1951) were accepted, the RBI began refinancing cooperative banks. By shedding the orthodox approach of a central bank and involving itself directly in areas concerned with rural credit, the RBI earned a unique place for itself among central banks. This
approach brought it closer to cooperative credit institutions and through them to the rural people and thus took it nearer to “what the central bank of this country ought to be”, as visualised by the All India Rural Credit Survey Committee (RBI 1985). The NABARD was established as an exercise to decentralise the RBI’s functions.

**Close and Organic Links**

The creation of NABARD was a part of the post-Independence Nehruvian vision of institution building carried forward by Indira Gandhi, who dedicated it to the nation on 5 November 1982 in the presence of Pranab Mukherjee, who was then the finance minister. At that time, the Committee to Review Arrangements for Institutional Credit for Agriculture and Rural Development (CRAFICARD) had envisaged an institution that would give undivided attention, forceful direction and pointed focus to rural development in the country. It recommended that the new bank take over the oversight of the entire rural credit system from the RBI, including the statutory inspection of cooperative banks and regional rural banks (RRBs). It also envisaged close and organic links between the RBI and NABARD and emphasised that the new entity should be able to draw upon the financial resources of the central bank. It was due to these factors that CRAFICARD provided for 50% of the share capital to be contributed by the RBI. It also stated that the central bank of the country should be fully behind NABARD and seen to be so (RBI 1981). The institution was thus owned by the people of India through the central government and also by the RBI, which indicated its solidity and financial soundness.

The 2009 Report of the Committee on Financial Sector Assessment (CPFS) was of the view that the structure of the RBI as the monetary policymaker, the lender of last resort and the regulator and supervisor, though quasi independent, was appropriate and could continue. It reduces the information risk that would otherwise be there between the monetary authority and the regulator and supervisor. This analysis is sound and practical, especially in view of the experience gained during the recent global financial crisis. This puts the RBI in a position of advantage on information flow from the regulator and supervisor to the monetary authority and vice versa. The report notes that the effective exploitation of synergy between the regulator, monetary policymaker and lender of last resort is advantageous from the standpoint of the institution (RBI 2009).

The Narasimham Committee-II stated, the RBI as a regulator of the monetary system should not be also the owner of a bank in view of the potential for possible conflict of interest. It would be necessary for the government/RBI to divest their stake in the nationalised banks and in the State Bank of India (RBI 1998).

It is interesting to note that the committee refers only to banks and that too to ownership by both the RBI and the government. By a selective reading of the recommendations it was interpreted to mean that the RBI needed to divest from the State Bank of India (SBI), NABARD and the National Housing Bank (NHB), and this was enunciated in the Monetary and Credit Policy statement for 2001-02 (RBI 2001). The other part of the recommendation, that the government divest its stake in the nationalised banks and the SBI, was conveniently forgotten. The RBI exiting from holding shares of the SBI can be considered reasonable as that bank is a purely retail banking institution. Institutions like NABARD and the NHB, which are apex institutions with supervisory and regulatory responsibilities, cannot be equated with the SBI. Further, for discharging their assigned roles effectively, these institutions should carry with them their central banking pedigree. Viewed in this context, the argument that the RBI’s shareholding in NABARD would be in conflict with its role as a regulator of the financial system has no validity at all.

**The Successes**

In the last 30 years, NABARD has built itself up into a unique institution. One could hardly find an institution of a similar nature in the banking sector anywhere else in the world. It combines the roles of a central bank, a development agency, a financial institution, an infrastructure funding agency, a microfinance institution, a planning board and an apex-level policymaker. NABARD plays an important role in grass-roots level credit planning and monitoring through its district presence. Its effectiveness in this role has been possible only because it is seen as an implementing instrument of the RBI. It has been able to leverage the knowledge and information of each of its functional areas to fine-tune and strengthen its effectiveness in other areas. For instance, it has drawn on its strengths with non-governmental organisations (NGOs) and other civil society organisations in watershed development initiatives and with the government’s development agencies to build up the institutional base for the Self-Help Group-Bank Linkage Programme. By investing huge energy and manpower in this programme and drawing on the synergies emanating from its myriad roles, NABARD has succeeded in making it the largest microfinance programme in the world, reaching nearly 100 million poor households.

Apart from microfinance, as part of the developmental mandate, NABARD has been undertaking a wide range of promotional initiatives aimed at improving the productivity of land, water conservation, rural non-farm sector, rural marketing and increasing farm yields to create models for replication that will be taken up gradually by other downstream organisations. Its success in these efforts has been mainly due to its ability to draw on the participation of a wide spectrum of institutions and exploit the synergy of its presence in the finance, development, planning and regulation/supervision spaces in the rural sector, and also because it is seen as an institution that has the backing of the RBI.

NABARD has a responsibility for institutional development in the rural financial sector. It took up an extended role in this area in the form of turnaround strategies for rural financial institutions (RFIs) in the period 1994-99 with reasonably positive results. The Development Action Plan (DAP) proved that it was possible to restructure and turn around state-owned RFIs without privatising them or neglecting their outreach. This effort had a substantial effect on the revitalisation of RRBs, which have today emerged as strong institutions catering to the financial needs of the
rural clientele. The revitalisation package recommended by the Vaidyanathan Committee (2006) for short-term cooperatives is now at an advanced stage of implementation. The reform programme has been successful in turning around a major part of the short-term cooperative credit structure in the country, enabling it to play a more meaningful role. In addition to these, NABARD has had a huge training and capacity-building involvement with RPS since its inception. In the case of its other major function, refinance, NABARD has been using it as a fine instrument to direct credit flow to desired sectors of national importance and to institutions that may be weak but provide credit to vulnerable sections of the population. NABARD has been able to carry out these institutional development and refinance roles effectively, only because it has a role in supervisory and credit planning and because of its ownership by the RBI.

The Shortcomings

However, this does not imply that NABARD has been able to do full justice to its mandate. There are many areas in which it has to take on greater responsibilities. The Agricultural Credit Review Committee (ACRC) of 1989, which, among other issues, reviewed the role and performance of NABARD, was critical of its focus on refinance business. It was of the view that NABARD needed to play a greater role in the development arena, especially in institutional development, and should have taken on a bolder developmental role in reforming cooperative banks as well as RRBs (RBI 1989). NABARD’s lack of initiative led to the cooperative banking system being debilitated until the Vaidyanathan Committee came forward with a reform package. Another area that NABARD missed was risk mitigation in agriculture. It should have in its initial years come out with robust mechanisms such as agriculture insurance and an agricultural relief fund. It did become a promoting shareholder of the Agricultural Insurance Company of India, but it still plays only a passive role in this area.

On the complementary roles of the RBI and NABARD in rural credit, it suffices to quote what Prime Minister Manmohan Singh said when he was RBI governor, The Reserve Bank has always been conscious of the fact that under Indian conditions, the central monetary authority must never lose sight of the strategic role of agriculture in promoting a balanced, equitable and a self-reliant pattern of development. An efficient system of rural credit is an essential ingredient of any viable strategy for the removal of poverty and for the modernisation of our rural economy. The Reserve Bank, both on account of the historical compulsions of the Indian economy and the special responsibility cast on it in terms of its statute, from its very inception, has, therefore, been actively involved in the process of institution building in rural credit. It has made determined efforts to ensure that the system of rural credit serves both the cause of accelerated growth and greater equity in the development process. ... With the establishment of the National Bank for Agriculture and Rural Development on 12 July 1982, the responsibility for refinance and development of rural credit institutions has now passed on to the new bank, which conceptually represents an exercise in decentralisation of the Reserve Bank’s functions. Thus, in a sense, this marks the end of an era of the Reserve Bank’s direct involvement in rural credit and the Reserve Bank’s proud legacy becomes the heritage of the National Bank for Agriculture and Rural Development. Of course, this change will in no way affect the Reserve Bank’s deep and abiding interest in the orderly growth of the rural credit system, in line with the broad national objectives and priorities of development (RBI 1985).

It should therefore be amply clear that NABARD has been envisaged as an institution that takes on a part of the RBI’s functions in a process of decentralisation. As such, as long as licensing, lending of last resort, refinance, administrative guidance, supervision, regulation, and also management of the banking sector are under the RBI’s purview, along with its role as the central monetary authority, and no conflict of interest is discerned in this role, its role as a shareholder of NABARD should continue so that NABARD can effectively play its all-encompassing role in rural development and the rural banking sector, which includes development, refinance and regulation/supervision.

Draw on Experience

The effort to delink NABARD from the RBI have to be seen in the light of similar experiences with the Industrial Development Bank of India (IDBI) and the Unit Trust of India (UTI), which had pioneered industrial finance and retail public investment respectively. The IDBI was established in 1964 as a wholly owned subsidiary of the RBI and played a leading role in catalysing broad-based industrial development in the country. As a development finance institution (DFI) it took a lead in project finance for industries as well as refinancing banks and state finance corporations for their industrial finance activities. The delinking of the IDBI from the RBI took place in 1976. In his evidence before the joint parliamentary committee, then RBI Governor S Jagannathan stated,

Broadly in the Reserve Bank and IDBI, we were not very clear as to the specific objectives which the government had in mind and we expressed the view that we were not able to see much advantage in the reconstitution proposed. Delinking will not be helpful because coordination work would become difficult. It was our view that there was not any substantial advantage in delinking, but there could be many disadvantages (RBI 2005).

Highlighting the performance of the IDBI in industrial finance as an associate institution of the RBI, C V Nair of the RBI Officers’ Association cautioned that delinking would mean a higher degree of bureaucratisation and a higher degree of non-professional management in the new IDBI. Describing the bill as a retrograde piece of legislation, the dissenting members of the joint parliamentary committee said,

The proposal to delink IDBI from RBI and functioning under the administrative control of the finance ministry will destroy the very foundation of the credit structure which has been built up in the last two decades. ... The evidence before the committee very clearly indicates that the Bill has been misconceived and should therefore be scrapped. The evidence further indicates that there is no valid economic or administrative reason for delinking the IDBI from RBI. The reconstitution of the IDBI as proposed in the Bill will not improve the operational efficiency of the IDBI nor will create better machinery for developmental financing, better coordination of credit operations, etc (RBI 2005).

The UTI was also a wholly owned subsidiary of the RBI, but the latter maintained an arm’s length relationship with it. The UTI was delinked from the RBI at the same time as the IDBI and was placed under the IDBI’s control. A former executive trustee of the UTI stated,

I think the transfer was a grave mistake. After all IDBI is a lending institution, not
a lender of the last resort. Also it does not have the comprehensive knowledge of the economy and the kind of research capability which the Reserve Bank has and which is necessary to give guidance to an investor-oriented institution like UTI. Moreover, since IDBI was now under the direct control of the finance ministry, this transfer meant that government could, if it chooses, influence UTI through IDBI. The original idea of the Trust being free from control of government was whittled down with this transfer (Pendharkar 2003).

The negative effects of the delinking from the RBI and complete government control of the IDBI and the UTI were noticeable within a decade of separation. In 2000-01, the IDBI reported gross non-performing assets (NPAs) of Rs 10,875 crore, which had wiped out its entire net worth of Rs 9,126 crore. It had written off Rs 500 crore as lost assets and other assets aggregating to Rs 6,285 crore had been restructured and rescheduled. The contamination of IDBI’s portfolio was a consequence of the control exercised by the bureaucracy, making it an organ of directed lending by the government, which in effect meant the political authorities. The UTI had to be bailed out by the government after the flawed US-64 scheme with a package of Rs 14,561 crore in 2002. In 2003, the UTI was reorganised into the UTI Mutual Fund and the Specified Undertaking of UTI (SUUTI).

Ultimately, the IDBI had to give up its role as a DFIs and reverse-merge into its own subsidiary, IDBI Bank, in 2004. The deterioration in the functioning of both these institutions can be directly attributed to absence of the tutelage and oversight of the RBI and the direct interference in their functioning by the bureaucracy and the political bosses. Direct government interventions in influencing credit decisions in the case of the IDBI and investment decisions in the case of the UTI, in the absence of the moderating role of the RBI, were largely responsible for the deterioration in their financial health and eventual collapse. This danger looms large even in the case of NABARD.

The ominous nature of direct government control has to be viewed in the context of the increasing tendency of the department of financial services (DFS) of the ministry of finance to micromanage the day-to-day affairs of public sector banks (PSBs) and financial institutions by issuing a plethora of circulars. This has been widely commented on in the financial press. One such article says,

By micromanaging PSBs without being fully equipped to do, the government officials could end up harming them through inappropriate advice … it is high time that the tendency of officials to shackel PSBs with circular-a-day on operational issues is curbed. Such matters are best left to RBI which has experts who have acquired long expertise in properly guiding banks (Viswanathan 2012).

The RBI governor had also made his displeasure known on this:

Occasionally, there are concerns over the government exercising ownership rights not through the established channel, which is the Board mechanism, but outside the Board …it is not an exemplary corporate governance.

In the case of NABARD, the proposed amendment tries to tamper with the board mechanism by whittling down its role and powers in the existing Act. The mandarins of the DFS are proposing to make it mandatory that all board decisions, including those regarding day-to-day business and administrative issues, be subject to government approval, which, in practice, implies a faceless section officer who does not have an iota of idea of banking and finance.

Dangerous Proposal

Any effort to disturb the sound arrangements for ownership and governance laid out in the present Act is not only illogical but also goes against the spirit with which those like B Sivaraman, G V K Rao, M R Shroff, L C Jain and other eminent development practitioners conceptualised this institution under the leadership of Indira Gandhi. It is shocking that this is being negated by the United Progressive Alliance (UPA) government led by the Congress Party, which claims to carry forward her policies and programmes. Perhaps one should not be surprised as the present ruling dispensation has abdicated its responsibilities to the bureaucracy. As political commentator Yogendra Yadav says, “Congress has surrendered governance to babus or babu-like politicians and outsourced politics to a few too-clever-by-half backroom boys” (Yadav 2012).

This can be observed in the proposed amendments to the NABARD Act. The know-all babus of the banking division of the finance ministry, who neither have an understanding of banking and development finance nor the experience, seek to keep out the RBI from NABARD and bring the institution completely under its control. Through this amendment it also seeks to subvert the autonomy of the institution, render the board powerless and emasculate its functioning. The stellar achievements of NABARD in the 30 years of its existence have been principally due to the relative freedom of operation permitted by the existing Act, the guidance of its board and the presence and support of the RBI as its stakeholder. All these are being sought to be upturned. An institutional legacy is sought to be obliterated by petty-minded and self-serving bureaucrats for whom “institution building” and “vision” are esoteric concepts.

It is therefore in the fitness of the things to ensure that the RBI’s role as a shareholder of NABARD continues in the overall interest of the agricultural and rural finance sector of the country. Development practitioners, civil society activists, parliamentarians, public persons and the farmers of the country should raise their voice so that a 30-year legacy of the people is not lost forever.

REFERENCES

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