shortfall in Government balances.[13] The ceiling on the Reserve Bank's investments in Government paper (and maturities thereof) in the Banking department in terms of capital, reserves and deposit liabilities had already been removed in 1951. In order to avoid problems of roll-over in view of sustained budgetary requirements, the Reserve Bank began to fund *ad hoc*s into marketable securities which could be offloaded to the market in due course by 1959, especially as the Banking Regulation Act, 1949, was amended in 1962 to raise the minimum statutory liquidity requirement to 25 per cent of banks' eligible demand and time liabilities from the original 20 per cent, in order to provide a captive market for Government paper.[14] In case of State Governments, an increase in the limit for clean advances was reinforced by the introduction of another facility of special advances against the pledge of Government securities in April 1953.

Although inflation was still believed to be structural, the central bank was not unaware of the potential for deficit financing to put pressure on prices.[15] Reserve requirements were enlarged from the original levy of a daily minimum of 5 per cent of demand liabilities and 2 per cent of time liabilities to between 5 and 20 per cent of demand liabilities and 2 and 8 per cent of time liabilities on an average basis (1956) and thereafter between 3 and 15 per cent of demand and time liabilities (1962). Additional reserve requirements were, in fact, imposed between March-November 1960, as monetary expansion began to feed inflation.

The size of the Reserve Bank Balance Sheet declined to 13.2 per cent of the GDP at current market prices during the 1960s from 14.8 per cent during the 1950s and 15.4 per cent during 1936-47. This reflected the gradual spread of banking habits with the expansion of the banking network during the foundation phase, inducing a shift from cash to the banking channel.

As the domestic interest rates in relation to the international interest rates were relatively higher during the latter half of the 1950s than during the first half of the 1950s, the switch in favour of domestic assets, boosted the rate of the Reserve Bank's surplus to 1.6 per cent of the asset base during 1957-62 from 0.9 per cent during 1951-56. Since the national funds were funded out of central bank income, there was a corresponding reduction in the rate of surplus.

Phase of Social Control

Although the foundation phase ended on a sombre note, the strategy of social control continued to be strengthened in the 1970s. The entire monetary and banking system came to carry out the objectives of the Government as the "primary entrepreneur" of the economy through an inter-linked programme of bank nationalisation, directed credit and concessional financing (RBI, 1985).[16] The Reserve Bank continued to provide substantial accommodation to the Government, especially during the first half of the 1970s in view of the difficult macroeconomic challenges fostered by war (1971), drought (1972) and the oil price shock (1973). The brief respite in the latter half of the 1970s following strong inflows, especially from the Gulf, after the launch of the Foreign Currency Non-Resident (Account) [FCNR(A)] scheme in November 1975 with the Reserve Bank's exchange rate guarantee, was dissipated by the early 1980s, when the severe strain on the balance of payments, primarily as a result of the second oil shock, required India to seek a line of credit with the IMF under its Extended Fund Facility. The fiscal gap began to widen further in the 1980s - the gross fiscal deficit averaged 7.7 per cent of GDP in the latter half of the 1980s - searing the macroeconomic balance (RBI, 2003).

The fiscal dominance of monetary policy deepened in the 1980s. Voluntary subscriptions were hard to come by despite the hike in interest rates on government paper during the 1980s. As a result, the Reserve Bank had to fill up the fiscal gap, with its net credit to the Government famously coming to account for 90 per cent of the monetary base in the 1980s, almost doubling the ratio of monetisation to GDP to 2.1 per cent during the 1980s from 1.1 per cent during the 1970s. The Reserve Bank began to lose control of its balance sheet as *ad hoc*s emerged as a mainstay of the Centre's fiscal deficit. By 1982, the Reserve Bank began to fund *ad hoc*s into an instrument