as Exemplar of Capitalist Myopia\(^3\) in *Economic and Political Weekly*, published later in 2010. Finally, a presentation of the arguments of the entire book formed part of the workshop on Nehru’s India held at NMML in May 2014.

I must acknowledge here the emotional and intellectual support I received from the late Professor Ravinder Kumar, Director of the NMML, during the entire period of my formal association with the library, and also for the access he obtained for me to the Jawaharlal Nehru Papers. The Jawaharlal Nehru Memorial Trust complemented this support by awarding me a fellowship which permitted me to undertake the initial forays into the historical material which provides the empirical basis of this book.

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Note on the bibliography: Reports published by the Government of India (GoI) have confusing and inconsistent formats (even those of a single agency such as the Tariff Board). I have tried to introduce uniformity in bibliographic references by treating the GoI as the ‘author’ of all documents; so the reference in all cases will be to ‘India’. Reports of all subordinate agencies of the government are then listed chronologically. The same applies to documents listed under ‘Great Britain’. Correspondingly, the Reserve Bank of India (RBI), which is not a subordinate office, is an ‘author’ in its own right.

From the mid-1960s up to the late 1980s, criticism had increasingly been voiced against the State’s attempts in India to direct and regulate processes of economic development. After the initiation of structural reforms in 1991, emphasis on the negative features of the policies followed from 1947 to 1991 has virtually precluded serious analysis of any enduring gains from those policies. This is largely because current analysis abstracts from the distinctive problems that attempting post-war economic growth posed for countries situated in the Third World, such as India. Thus, the criticism has ignored any consideration of the crucial role of State-sponsored structural change which accompanies economic growth (and industrial development, in particular) in predominantly agrarian societies.

Although the Indian economy was predominantly agrarian, it had specific features which possibly made it unique in the post-war world. With the development of the Indian cotton textile industry from the mid-nineteenth century and the involvement of Indians in large-scale trading activities associated with the imperial industrialized economies, a (large-scale) merchant and broker/intermediary community had crystallized.\(^2\) The two world wars had allowed capital ‘accumulation’ in other ways, including blackmarketing and swindling in government contracts.

1 Streeter and Lipton (1968); Bhagwati and Desai (1970).
2 The formation of the Indian Federation of Chambers of Commerce in 1927 was the organized expression of this consolidation.

\(^3\) *Economic and Political Weekly*, XLV, 32: 47–55.
During the Second World War in particular, existing accumulations of money capital were further swollen by speculative activities, while entry into new industrial ventures which could have been facilitated by wartime import restrictions that relieved the pressure from international competition were, as the response to the Roger and Grady Missions shows, actively discouraged. With the repatriation of British interests in jute, engineering, and the plantations at the time of Independence, and with a secure home market assured, the swindler and blackmarketeer ‘accumulations’ were invested in the associated enterprises, particularly in eastern India. Some of these accumulations were spent on acquiring managing agencies, while others were expended in buying large blocks of company equity. A large number of very reputable firms thus came within the control of individuals or groups who had a tenuous connection with the industrial economy. The point to be emphasized here is that while the merchants and brokers/intermediaries had an appreciation of the imperatives of the process of industrialization, the other social groups had none. They were overnight transformed from members of slightly risqué social groups into ‘captains of industry’.

The years between 1947 and 1966, covering the period from Independence to the end of the Third Five-Year Plan, provided the arena for the most acute debates over the content of industrial development. In essence, these controversies centred on the form of ownership and control of the industrial undertakings which were already in operation and those which were to be established. Primarily at issue, thus, were the roles of the public sector and of the private sector on the one hand, and of Indian and foreign capital within the private sector, on the other. This book is based, however, on the proposition that industrialization in India involved not only the establishment of new enterprises by individual businessmen, or even by the government, but also measures of social engineering by the State. It was not simply a question of the State entering the industrial field in areas of high risk or those involving long gestation periods and/or large volumes of capital, leaving other fields to private enterprise. State activity, whether in the area of industry proper or in complementary spheres, was essential to nurture the development of entrepreneurs with a truly ‘industrial’ frame of mind.

The thrust of the argument presented in this book is that it is this major challenge—of achieving a large task of social engineering—which faced the political executives of the Indian State when planned industrialization became the proclaimed objective. And it is this challenge, both economic and social, that should form the context of a historical evaluation of State initiatives. It was not recognized in the early examinations of the planning process, such as those by the National Planning Committee, nor by contemporary or subsequent academic commentators. In other words, this factor has been largely, if not entirely, overlooked in discussions on Indian industrialization.

Levkovsky’s work noted that in the colonial Indian context, there were marked differences with the processes underlying the Western European experience. In India under colonial rule, the process of the emergence of the more complex forms of industrial organization through the increasing division of labour, demonstrated by the transition from independent artisanal production to (manually operated) manufactories, and, finally, to (power-driven) factories, did not take place. Factories emerged directly in the nineteenth century in a form of organization imported from Britain. However, while in Britain...
these institutions embodied concentration of industrial capital, in India, the factory form merely cloaked concentrations of merchant and usurer capital. For a relatively long period, Levkovsky states, factory owners continued to engage in moneymaking and trade alongside manufacturing operations. The process of an ever-increasing concentration on manufacture and organized forms of trade and banking (as opposed to moneymaking) was long drawn out. In fact, until the world economic crisis of 1929–33, capital engaged in traditional trade and moneymaking increased in absolute terms, though declining as a proportion of total non-agricultural economic activity. Thus, while mercantile and usurious accumulations of money capital certainly formed the basis for the initiation of industrial enterprises, the influx of merchant and usury capital from associated enterprises continued alongside ongoing processes of industrial capital accumulation. Thus, even the growth of the assets in a manufacturing enterprise could not be taken to be entirely the result of industrial capital accumulation. The critical point here is that the moment in the process of development of industrial capitalism is to be assessed, the volume of capital invested in industrial enterprises can only be a proxy, though it is an important empirical measure.

This book's analysis is based on the political economy premise that industrial capital, merchant capital, and usury capital are distinct forms of capital, with identifiably different methods of accumulation associated with each. While merchant capital expands through profits made in the buying and selling of commodities, usury capital grows through the interest on the loans advanced by a moneymaker. In the processes underlying the growth of merchant and usury capital there is a redistribution of value already in existence, from the consumer of the merchant's products or the recipient of the usurer's loan to the merchant or usurer, respectively. However, in the production process, new value is created by the application of labour power to the raw material purchased by the industrial capitalist, and it is this new value that (uniquely) underlies the growth of industrial capital. An index of the degree of industrial development is then provided by the relative importance of these three methods of accumulation within a given economy during a specific historical period. In situations such as those that Maurice Dobb had examined in Western Europe, with industrialization the importance of industrial capital increased secularly, while that of merchant capital declined relatively. Usury was also gradually reduced in importance as the role of peasant-based agriculture, with its related phenomenon of low and precarious incomes, declined. Capital engaged in commercial credit facilities geared both to production and consumption did, of course, become increasingly important, but this was decidedly an activity distinct to usury.

There have been substantial contributions to the understanding of India's industrial growth during the pre-Independence period. Starting with D.R. Gadgil, D.H. Buchanan, Vera Anstey, and P.A. Wadia and K.T. Merchant in the pre-Independence period, there were major additions to the scholarly literature from the 1970s, all of which addressed, explicitly or otherwise, the question of the impact of colonialism on the historical record of industrialization. The most distinctive feature that differentiated the approaches, which were otherwise quite varied, was one of two underlying views: either that arrested development was an empirically demonstrable phenomenon with colonialism as its principal cause; or that colonialism, while being a historical reality, played no empirically significant role in the development of Indian industry.

Common to all these analyses, however much they differ in their approaches, is, quite naturally, a focus on industry (in Buchanan's phrase, on capitalistic enterprise). Perhaps the only exception was Andrew F. Brimmer's analysis of the 'setting' of entrepreneurship in India. The institutional setting for entrepreneurship, in Brimmer's view, was not the industrial enterprise itself but the organization that actually held all operational control over it—the 'managing agency'.

10 Levkovsky (1966: 231).
12 Dobb (1965).
13 Gadgil (1971); Buchanan (1934); Anstey (1942); Wadia and Merchant (1957); Bagchi (1972); Ray (1979); Markovits (1983); Morris (1983); Roy (1990); Mukherjee (2002).
14 Brimmer (1955).
In fact, his analysis made it clear that the issue was momentous for a serious study of Indian industrialization. It implied that if the moment (the precise stage) of development of industrial capital was to be truly assessed, it was to be clearly noted that the managing agency firm was the firm in the sense in which this term was known in institutional economics. If the firm was defined as the institutional setting in which entrepreneurial decisions were made, it was immediately clear why the managing agency should be so designated. To achieve the ends of expanding their capital, managing agents generally made use of the joint stock form of organization for the companies launched to undertake actual production and trade. These latter companies were then to be considered as operating units of the central, decision-making unit, the managing agency firm.\footnote{Papendiek (1978) has an interesting analysis of the major managing agency of Andrew Yule and Company and the operations of their coal enterprises. This empirical analysis bears out the general point being made in the text.} To understand the substance of economic activity encompassed by the managing agency system, then, it was critical to avoid a preoccupation with the managing agency merely as a legal entity, as also with the whole system of company law in India:

With a few notable exceptions, the Indian [managing] agency firms seem to administer the operating companies under their control with a view to obtaining the maximum profit in the shortest possible time ... the detractions to the reputation of Indian industry made by Indian [managing] agency firms have been made by businessmen still in the process of maturing.\footnote{Brimmer (1935: 359). Emphasis mine.}

The implications of this understanding are more profound than may be immediately apparent. If a manufacturing firm is merely an operating unit (or even only one unit of many) of a managing agency, which is itself an organizational expression of an accumulation of merchant or usury capital, then it cannot be held that the capital that is comprised of the agency and associated manufacturing units necessarily represents industrial capital as a whole. The situation is analogous to the historically familiar case represented by a handicraft establishment subordinated to a trader. The trader in this case, not the master artisan nominally in control of production, was the actual entrepreneur. There is extensive discussion in Indian economic history of whether enterprises of this type represented production of an industrial capitalist form or even provided the 'pre-conditions' for industrial capitalism.\footnote{Habib (1965); Chicherov (1976); Pavlov (1978).}

This book differs from earlier studies in that while its argument is firmly located within the view that colonialism did play the single most important role in retarding the growth of the Indian economy, its focus is on the development of industrial capitalism, in the sense that political economy views the process, rather than on 'capitalistic enterprise'. It postulates that for this reason the managing agency system, and not the enterprises that were established and controlled by these agencies, should be the focus.

The managing agency was a closely held firm, whether a single proprietorship, partnership, or limited liability company through which, under specific agreements, a variety of enterprises covering the field of industry, trade, and moneylending came under unified control. 'Agency Houses' originated in the late eighteenth century as partnerships of employees of the East India Company.\footnote{Kling (1966: 38); Misra (1999), ch. 1.} They provided the means for private business activities, whereby loans were advanced to indigo manufactories and manufactured dye received on consignment for sale in Europe. They were also the means through which surplus funds were invested in government securities, in shipping and docking services, and in sugar production. The bulk of international trade, including the shipping of opium to China, and the private trade between Bengal and Europe was channeled through their hands. In their time the agency houses held unchallenged control of the commercial life of Calcutta.\footnote{Kling (1966: 38); Misra (1999), ch. 1.}

The agency houses also operated the handful of joint stock associations founded before 1834. Though the joint stock form was limited to insurance and laudable societies, the employment of agency houses as managers provided the organizational model for the later managing agency system.\footnote{Kling (1966: 38); Misra (1999), ch. 1.} Use of the joint stock form of organization freed
the agency from the full risk of the new enterprise, while its agency agreement permitted it to maintain control over all management decisions.

In the subsequent 120 years of its unregulated existence, the managing agency survived despite criticism that was regularly voiced, as will be described later in this book. Various liberal commentators have claimed that although the managing agency system may have outlived its utility, it played an important role in supporting early efforts in industrial development: in particular, that industrial enterprises were floated at a time when there was little possibility of public participation in share issues, and that the managing agencies nurtured these firms until their viability and profitability had been demonstrated. What is not clear is whether the promoters took an exorbitant commission over an extended period in return for providing this time-bound initial support.21

The relationship between the managing agency and the associated enterprises remained unregulated, in any meaningful sense, by company law during the entire colonial period, and it was only in the 1950s that this nexus became subject to legislation. The book holds the view, further, that it was the institution of the managing agency that enabled the infusion of money capital, accumulated through varied non-industrial activities mentioned earlier, into industrial enterprises; however, it also allowed the reverse: the transfer of industrial surpluses into trade and rural moneymaking.

The conglomerate nature of large Indian capital including its operation through the business group, comprising firms not only in varied industrial fields and modern banking, but also in trading and indigenous banking operations, had been widely noticed even before the first systematic exploration by Asoka Mehta in 1939.22 However, beyond occasional references to the ‘merchant’ characteristics of industrial capitalists, the implications of such group structures on industrial performance were not fully appreciated. Typically, in what is still regarded as the classic account of industrial organization in the interwar period, P.S. Lokanathan did mention the fact that Indian managing agencies were generally firms which had had a financial, rather than an industrial, character; he also noted the critical point that rather than using the banking system, these agency firms often invested surplus cash in hundis (traditional forms of negotiable instruments through which prospects of earnings were of a greater order).23 However, neither of these insights underlies his analysis. Vera Anstey also remarked on the shortcomings of managing agencies, and mentioned the charge that the surplus funds of firms were often cornered by shroffs (indigenous bankers) who were also their managing agents, but as the points were made in the course of acknowledging a litany of accusations made against them, she was not compelled to address this issue.24 Much later, Brimmer characterized the Indian managing agencies as ‘primarily financial in character’; at about the same time, the situation was described in more detail, but once again in a footnote disassociated from the analysis in the text:

This [class of business leaders] is a new class of financiers, who have no traditions, except those of speculative finance and usury. Some of them earned their fortunes on the stock exchanges and commodity markets. But their spread of activities includes sowcar (village money lending), sarafi (urban indigenous banking and money-lending combined), dalali (intermediary finance, mostly on the stock exchange, bullion, and commodity markets), &c...25

There is recognized here the distinction between industrial capital on the one hand, and merchant (trading) or usury (moneylending) capital even when in ownership, control, and operation of industrial enterprises, on the other.

Trading or moneylending activities, empirically distinct from manufacturing, had, of course, been identified. However, the critical distinctions between these forms of existence of capital, when in ownership of industrial enterprises have generally been omitted from analysis. The ownership of a diversity of enterprises implies an obvious diversity of

22 Originally published under the title ‘India Comes of Age’, the article was republished along with a similar study of the situation in 1949 in Mehta (1950).
23 Lokanathan (1935: 303, 305, 319). Managing agencies and their role in permitting unfettered business operations under the legal protection of limited liability are discussed in later chapters.
economic interests which engaged the attention of the owners of the group, but also underlies the ‘diversity’ of their social identities, at various stages of evolution from speculators, moneylenders, and traders to industrialists. It was not, as has been implicitly assumed, that business group policies were neatly ‘industrially oriented’ when they concerned industrial firms in the group, and trader or moneylending oriented in the case of trading or traditional banking firms.26 There was an integrated management philosophy that guided strategic decisions covering all the capital resources at the disposal of the group. Thus a
typical Marwari family firm, unlike a European jute mill, was linked to several activities—from aradari and kutcha baling in the up-country marls to manufacturing, baling and fatka in Calcutta—all controlled, like zaibatsus by the family patriarch and his ruling council and operating by consensus. Though the firms were nominally under different names and registered separately, the attempt was to maximise overall profits covering interdependent complementary and competitive activities. Thus, a Marwari firm’s profit calculus was quite different from, and often at variance with, the norms of ... [the Indian Jute Mills Association] ... and the European mills.27

Again, empirically, it was recognized that in the jute industry some entrepreneurial interests, after accumulating capital through trading or moneylending, established entirely new jute mills (G.D. Birla and Sarupchand Hukunchand), while others bought controlling blocks of shares in existing mills and elbowed their way onto the boards of these companies, and even displaced the incumbent managing agents.28 These quite distinct ways in which Indian industry grew were representative of equally clear distinctions in processes within the political economy. The first embodied the transformation, however partial and slow, of capital accumulated in trade and/or through moneylending into industrial capital as the enterprise grew, while the second signified the phenomenon of the parasitic control of an industrial unit by representatives of yet incompletely transformed merchant or usury capital.29

There were two further challenges little noticed or commented on, academically, that faced the political executive. There was the lure of quick and high returns available to urban industrial capital through diverting its resources into the rural money market. One effect of the colonial constraints on industrial development was that surplus funds in the hands of capitalists found channels of high returns through commercial operations in rural land transactions, and in extending funds to rural moneylending. This phenomenon was empirically substantiated by the investigations of the Central Banking Enquiry Committee in the early 1930s.30 Twenty years later, the All-India Rural Credit Survey conducted by the RBI confirmed the continuing existence of links between urban large-scale capital and the rural money market.31 This flow not only bled the industrial sector of funds to cover replacement costs of plant and machinery, but also provided a stable base for an economic nexus between urban industrialists and rural moneylenders. In this context, this book points attention to an ignored aspect of the bank nationalization measures of 1969. This was the effect of State control over credit disbursement that was aimed at reducing the flow of urban money accumulations into the rural money market.

Finally, the situation in India was unique in that the capitalists who had emerged during the pre-Independence period were drawn into the national movement, specifically into influential positions within the Indian National Congress. This early support gave them

26 Rajat Ray is one of the few authors to have moved beyond merely noting the conglomerate nature of Indian business groups to granting that this implied the simultaneous engagement with manufacture, trade, and moneylending. He too, however, does not consider the accompanying dilution of the industrial imperative when undertaken in these combinations. See his discussion of the role of G.D. Birla’s concern for ‘real entrepreneurship’ in the Introduction to Ray (1992: 58–9).
28 Goswami (1985: 231–4) describes these two processes.
29 Thus: ‘In the first place, the surplus funds of a concern are often taken over by the managing agents as deposits with them, and although the usual interest may be paid on them, they are utilized in their own agency businesses or loaned out to allied concerns. Secondly, funds are borrowed in advance for the purpose of making extensions, and till the time they are actually needed, they are employed elsewhere in allied concerns or in the managing agent’s own business’ (Lokanathan 1935: 309).
30 India (1931: 99).
not only privileged access to senior politicians, but also a moral authority to project policy measures which they could claim were not based solely on a narrowly focussed self-interest. The very close nexus long established between some sections of capital and the Congress Party made decisive political action problematical. This nexus is often overlooked when comparisons are made between the indecisiveness of Indian policies and the precision with which the government extracted appropriate responses from private entrepreneurs in East Asian societies.

The tricky point, as T.T. Krishnamachari, the then minister for commerce and industry, was to remind Jawaharlal Nehru, was that while they might privately agree that some industrialists were unsavoury, they were the only industrialists that the country had. Business had to be done with them. However, doing business could not be coterminous with allowing the firms to be managed in any way the industrialists chose. Interestingly, there is also evidence that the necessity of administrative coercion in these matters was understood by the more advanced industrial entrepreneurs. Sunant Moolgaokar, of the Tata-promoted firm of Tata Engineering and Locomotive Company (TELCO), currently known as Tata Motors, pointed out to Krishnamachari that the government was the only agency through which the productive efficiency of the manufacturing sector could be increased. As an industrial manager, Moolgaokar saw the problem at the level of the individual firm, while the critical problem, of course, lay at the level of the social composition of the industrialists.

Theoretically, too, the importance of moving away from the firm to the social group is emphasized by a consideration of the role of the State in extending the time horizons of the business community. This, along with the appropriate technological educational inputs, helps in the problematical transformation of a class of merchant-usurers into industrialists. In India, the major instruments for channelling resources into activities necessitating longer time horizons were, apart from the fiscal instrumentailities of the State, in the form of legislation, specifically the Capital Issues (Control) Act, the Companies Act, and the Industrial Development and Regulation Act (IDRA). All these acts represented potentially coercive administrative measures, aimed at strengthening the ‘industrial’ characteristics of private resource allocation decisions. In the event, the Capital Issues (Control) Act playing a subordinate role to the industrial licensing system, instituted by the IDRA, was of little independent significance. The IDRA, a key to social control at the level of the firm, did not ever achieve this goal. Initially instituted during the period when the ‘Economic Consequences of Sardar Patel’ were most visibly present, it was finally legislated shorn of its more significant social and political attributes. It was thus the Companies Act, identifying thereby the focus of social engineering as the company (a financial

32 Letter dated 2 September 1954 from T.T. Krishnamachari to Jawaharlal Nehru, T.T. Krishnamachari Papers (subsequently TTK Papers), subject file 8 (A), pp. 120–4. T.T. Krishnamachari (1899–1974), initially elected to the Madras Legislative Assembly as an independent member, later joined the Congress. In 1946, he became a member of the Constituent Assembly and of the Constituent Drafting Committee. From 1952 to 1956, he was minister for commerce and industry and from 1956 to 1958, the finance minister. He became a minister again in 1962, holding the portfolio for economic and defence cooperation and then again the finance ministry, from 1963 to late 1965.

33 Letter dated 5 October 1953 from Sunant Moolgaokar to T.T. Krishnamachari, TTK Papers, correspondence with S. Moolgaokar file, pp. 1–3. Sunant Moolgaokar (1906–89) was an engineer trained at the City and Guilds Institute and Imperial College, London. In the pre-Independence period he worked in the cement industry and helped develop the manufacture of cement machinery during the Second World War. After the formation of TELCO in 1945, he was closely associated with its development until his death. He played an active role as a consultant in planning the development of the heavy engineering industry.

34 Policy towards the small-scale sector has been examined in Tyabji (1989).


36 The phrase is from the title of Asoka Mehta’s pamphlet (Mehta 1949). Asoka Mehta (1910–84) helped organize the socialist wing of the Indian National Congress, along with Jaya Prakash Narayan, and was closely involved in the politics and government of the city of Bombay (present-day Mumbai). Mehta was an active participant in the Quit India Movement and was sentenced to rigorous imprisonment five times. After Independence, he helped organize trade unions in Bombay and was one of the founders of the Indian National Trade Union Congress (INTUC). Mehta retired from active politics in the early 1950s and wrote several books on his experiences, on India’s independence movement and the importance of socialist-oriented reforms. He was a founder member of the Socialist Party, and when in September 1952 the Kisan Mazdoor Praja Party and the Socialist Party merged to form the Praja Socialist Party (PSP), Asoka Mehta became the general secretary of the new party. He was the Praja Socialist Party’s president during 1959–63.
unit), rather than the firm (a productive unit), that provided the most effective legislative key to social engineering. And it is the Companies Act with which this book is mostly engaged.

A project to extend the time horizon of an entire social group, and that of the dominating social force at that, not only requires the acquiescence of the more advanced sections of this group of proto-industrialists in the necessity of such measures, it also requires the politically adroit combination of measures to ensure compliance with the accumulation norms of an industrial society.

At the beginning of this Introduction it was stated that criticism of the early post-Independence policies had abstracted from consideration of the requirements of State-sponsored structural change. It should be emphasized that the original, publicly stated, policy intention was equally silent on these issues. However, the silence must here be explained as a result of the blandness which necessarily characterizes State policy. It is precisely this silence that explains the choice of particular instances in India’s history in this book, when crises of varying severity forced the disclosure of events and processes which otherwise remain within the privileged domain of the government. The episodes considered here—the capitalist initiatives towards presenting a plan following the Quit India Movement in 1942, the presentation of the Liaquat Ali Khan—Budget in 1947, and the drama surrounding the Dalmia-Jain and Mundhra cases—are all cases in point.

In February 1958, musing over just how a situation had arisen by which an outstanding minister, T.T. Krishnamachari, was likely to be forced to resign over the fallout of the ‘Mundhra Episode’, M.O. Mathai had an explanation to offer.37 In a note to Jawaharlal Nehru, Mathai argued that the great jubilation amongst some Gujarati and Parsi businessmen over the situation was basically due to the fiscal policies that Krishnamachari had pursued. Continuing, Mathai explained that based on various kinds of information available to him, including messages from ‘decent’ businessmen, it was apparent that the campaign was the first attack on (Nehruvian) socialism. It was, indeed, also an indirect attack on Nehru. Opponents of this ideology were openly proclaiming that socialism would disappear with Krishnamachari’s exit. Further, so the argument went, as the head of the government Nehru should also resign. A week later, bowing to the inevitable, Mathai pointed out that if Krishnamachari had to go, as seemed certain by then, there was an uncomfortable fact to be faced: that he had been sacrificed for implementing policies that he had introduced as a loyal comrade of Nehru.38

This book, based on contemporary records, reaches the conclusion that while this was indeed so, there was a more viscerally felt reason for the opposition to Krishnamachari. This lay in the Rama Rao episode. Though less glamorous, this drama had led to the resignation of the RBI governor, B. Rama Rao, in December 1956 over his inability, in his perception, to prevent the infringement by the government of the RBI’s autonomy in determining monetary policy. Actually such a perception of events trivializes the historical importance of the episode: it was part of a strategy to institute an effective industrial policy by subordinating monetary policy to the demands of industrial development. Further, this book argues that Krishnamachari tripped in attempting, through the stewardship of the finance ministry, an ambitious programme of social engineering: he tried to force a section of the dominant bloc of businessmen who had acquired control of industry to behave like true industrialists, rather than engaging in moneymaking, speculation in stocks and commodities, or asset stripping. In this, his political fall from grace provides an object lesson in political economy: the deadly consequences of misreading the limits to the relative autonomy of the State.

More successful was the effort to unravel the Dalmia-Jain Group’s mode of operation. This book postulates that the group represented one of the largest concentrations of largely unreformed merchant/usury capital, and that their methods of using the nexus between their managing agencies and associated manufacturing firms quintessentialized the behaviour of this form of capital. Ultimately, the disclosures of the Dalmia-Jain investigation led to the abolition of the managing agency system in 1969. It should also be noted that despite the dramatic aspects of the Haridas Mundhra case, his operations were stock market speculations, unconcerned even with gaining management control except in the very short term; much more corrosively,

37 M.O. Mathai was Special Assistant to Nehru. Secret note, 2 February 1958, Jawaharlal Nehru Papers (subsequently JN Papers), File no. 590, p. 8a.

38 Note, 1 February 1958, JN Papers, File No. 593, pp. 244-3.
the Dalmias specialized in devising means of squeezing all the liquid assets out of well-functioning industrial enterprises which came under their control.

To recapitulate, the thrust of the argument of this book is that the existence of a class of businessmen does not automatically mean the existence of a group of industrially oriented entrepreneurs, because the development of industries is not necessarily the only money-making activity available to them. Even acquiring the position of being in charge of industrial ventures does not automatically convert businessmen into industrialists because they could very well use their control to divert resources into other non-industrial activities.\textsuperscript{39} It therefore requires a historical process of a definite nature for a class of true industrialists to come into being. In the Indian case, colonialism and ‘arrested development’ formed the context within which emerged the group of businessmen responsible for managing industrial ventures after Independence. They were part of an imperfectly formed group of industrialists possessing characteristics that reflected their background of engagement in non-industrial activities—activities with which they continued to be involved, even as they acquired control over industrial companies. In 1949, the Bombay Shareholders’ Association in a memorandum listed questionable practices by managing agencies owned by Birla Brothers, Dalmia-Jain, Karamchand Thapar, Jaipuria, Walchand, Surajmull Nagarmull, Sarupchand Hakumchand, Kamani, and Bajoria amongst the more prominent business groups. This made them all, as will be argued in this book, prone to a particular kind of fraud greatly inimical to the industrialization effort.\textsuperscript{40} It also meant that the State had to play a crucial part in transforming this group into a class of true industrialists. The 1950s and 1960s are naturally important in this regard being the critical early years of post-Independence industrialization.

\textsuperscript{39} The possibility of such moves (admittedly in the short term) even in a fully industrialized economy has been suggested by Dillard (1980: 259).

\textsuperscript{40} Bombay Shareholders’ Association (1949: 74–82). Further empirical evidence for this proposition is available in Bombay Shareholders’ Association (1936); see also India (1958\textsuperscript{a}, 1958\textsuperscript{b}, 1963).

\textbf{CHAPTER ONE}

Capital Accumulation under Colonial Economy and Company Law

\textbf{THE PROBLEM IDENTIFIED}

By the start of the First Five-Year Plan in 1951, the four years of experience since Independence had reinforced in the government’s perception several dysfunctional features of the operations of private capital in the industrial field.\textsuperscript{1} In this perception, speculative commercial practices which flourished during the Second World War had left legacies which impeded the industrial development of the country. In fact, attempts to deal with illegal wartime accumulations and to prevent the siphoning of resources through manipulated share price rises had been a feature of the budget presented by the Congress Muslim League Interim Government in early 1947.\textsuperscript{2} The tax proposals in this budget, the formation of an Income Tax Investigation Commission, and the continuation of wartime controls on the issue prices of shares with the Capital Issues (Control) Act were then presumed to be able to deal effectively with what were conceived to be temporary, war-situation-created anomalies.

\textsuperscript{1} This was the thrust of the speech in Parliament of the then minister of state for finance, Mahavir Tyagi, when introducing the Indian Companies (Amendment) Bill 1951. Indian Companies (Amendment) Bill 1951, Parliament of India Debates, vol. XIV, part II, 16.8.51 cols 710–12.

\textsuperscript{2} The Interim Government’s budget and related proposals are discussed in detail in Chapter 3.
CHAPTER SIX

Private Industry and the Second Five-Year Plan

The Dalmia-Jain and Mundhra Episodes

PROTECTING INDUSTRY FROM PREDATORY CAPITALISTS

In early 1955, at its annual session held at Avadi, near Madras, the
Indian National Congress passed a resolution declaring its aim to take
India towards a socialist pattern of society. Even before this resolution,
it was becoming apparent to British interests operating in the
form of managing agencies that the halcyon days of their unhindered
business activities were not likely to last much longer. Although they
supported a determined effort to retain the managing agency system
which ultimately continued for the next 15 years, repatriation of capi-
tal was clearly a major preoccupation.¹

In the middle of 1954, the Dalmia Group attempted to use this
moment of vulnerability by attempting to buy a substantial block
of shares in one of the major British managing agencies in Uttar
Pradesh—the British India Corporation (BIC). Although this effort
failed, a year earlier, the Dalmia Group had provided evidence that
the managing agency system enabled financial manipulations that
even the most demanding financial analyst could not fault on legal
grounds.² It was a Dalmia financial company, Bharat Insurance, that

¹ As discussed in Chapter 5.
² "Proceedings against Messrs Dalmia-Jain Airways Ltd and other Dalmia's
Concerns" typewritten, undated, unsigned note, C.D. Deshmukh Papers, Subject file 1.

was subject to scrutiny by a specially appointed professional au-
ditor. On the basis of his report, a change in management was rec-
commended by the relevant authority, the controller of insurance.
However, the group appealed for a rehearing of their case with the
government and, finally, the matter was resolved by a method that left
the Dalmias in an advantageous situation.³ There were four charges
made against the firm: first, that the company transmitted large funds
from time to time to Ramkrishna Dalmia's son-in-law, Shanti Prasad
Jain, and the Dalmia Cement and Paper Marketing Company for the
ostensible purpose of investment, but really in order to allow them to
make illegal use of the money; that government and other approved
securities supposedly to be held under the Insurance Act were never
actually bought; that large investments were made in related Dalmia
enterprises at inflated prices; and that property was bought from
other Dalmia firms, also at inflated prices. Of these charges, the first
two were the most critical in that they alleged a straightforward diver-
sion of funds. However, precisely because of the leeway for financial
manipulation that the managing agency system provided, they could
not be proved. In effect, Dalmia's only penalty was the requirement
that they buy back from Bharat Insurance valuable urban property
(the Times of India building in Mumbai) within 10 years at the same
price at which it had been sold.

At the end of the following year, a representation made by the
employees union of the Times of India and Allied Publications alleged
that benami share transfers had taken place from Ramkrishna
Dalmia to Shanti Prasad Jain. By this time the government, frustrated
by five years of attempts to pin down the mechanisms through which
the Dalmia Group's financial manipulations were undertaken, had
begun to consider the option of an enquiry under the Commissions
of Enquiry Act.

After the failure of even the Income Tax Investigation Commission,
it had dawned on the government that its own concerns of safeguar-
ding its sources of revenue were directly linked to issues of shareholder
democracy, that is, to the manipulations made possible by the man-
aging agency system. Without the legally prescribed disclosure of

³ Letter no. 853-PSF/54 dated 21 April 1954 from the finance minister to Jawaharlal
Nehru, JN Papers, File no. 298, pp. 85–6.
the operational results of firms, it was impossible for investigators to trace the means by which company managements could manipulate records, set up dummy directors, and transfer funds from publicly held companies to the promoter's closely held companies. While auditor's reports occasionally provided evidence of these practices, the provisions of civil law, when invoked to identify and collect concealed income, could be challenged. The only control on corrupt practices was through shareholders' vigilance, but while company management could win over cantankerous elements amongst them, the bulk of shareholders were inclined to be apathetic. Thus, shareholder's interests and government revenues could be better protected by changes in company law which would require greater disclosure of all operational results. Although the commission of enquiry would not meet either the shareholders' or the government's purposes directly or quickly, the public would be educated about the kinds of manipulations that managements engaged in and it would equally allow the government to identify the precise ways in which company law required to be changed.4

The essential feature of the devices that the Dalmia Group used was that of interlocking of companies, clearly through the mechanism of the managing agency system.5 Thus, Dalmia-Jain Airways, a major company in the group, was amalgamated with Dalmia-Jain Aviation after it had suffered major losses due to mismanagement. Records of the company were subsequently destroyed through a board resolution at which only three board members, all Dalmia employees, were present. Dalmia Cement and Paper Marketing Company, entirely owned by Ramkrishna Dalmia, was used as the clearing house of the group, with all speculative profits accruing to Dalmia while losses were transferred to other group companies. Dalmia's personal expenses were also debited to the company. Shriyans Prasad Jain (Shanti Prasad Jain's brother) was appointed to a tax-free salary of Rs 4,000 per month and shortly thereafter, when this appointment was terminated, a compensation of Rs 7 lakh was paid to Jain. The Shapurji Broacha Mills and the Madhowji Dharmasi Manufacturing Company, both profitable and well-established firms, were cornered by Dalmia, and his closely held companies made sales agents for them. When these arrangements were ended, a total of Rs 14 lakh was paid as compensation by the Mills, which accrued to the selling agents. The decision to terminate the selling agencies and authorize the payment of compensation was taken by two directors, both Dalmia employees. Ultimately, the Mills were taken into liquidation. Funds of Bharat Insurance were placed at the disposal of Shriyans Prasad Jain and though they had been given for investment in shares and securities they were used to acquire or to retain control over other companies.

The general pattern appeared to be the same in all companies of the group. Funds were not used for the purpose for which the firms had been established and for which public subscriptions had been enlisted.6 They were invested in other companies of the group. As these shares were not dividend-paying, the funds were available free of interest. After a few years, the shares would be transferred to the closely held group companies as a security for loans, and an agreement would be reached between debtor and creditor companies that the loans would be repaid without interest, in a number of yearly installments. Sometimes the loans were adjusted against compensation payable to the closely held firms to terminate their agency agreements.

The point was that taken by themselves, and isolated from the chain of events in the group as a whole, many of the actions appeared to be within the letter of the law, or at worst, trivial offences.7 It was then considered essential to probe into the affairs of the group as a whole and obtain an overall picture of the state of affairs within the Dalmia Group and the ways in which the investing public had been duped by the opportunities to appropriate public funds that the interlocking of the group companies had provided. However, given that the powers of

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5 JN Papers, File no. 443, p. 86, letter no. 0365-PSF/56 dated 15 May 1956 from the finance minister to Jawaharlal Nehru.

6 JN Papers, File no. 443, p. 79.

7 As early as 1949, the memorandum of the Bombay Shareholders' Association had pointed to the Dalmia-Jain Group, and to other similar cases, and demanded an ordinance to prevent interlocking of companies. See Bombay Shareholders' Association (1949: 206-11).
a commission of enquiry were limited to those of a civil court, it was proposed to modify the rules of procedure to give the commission powers similar to the Income Tax Investigation Commission.8

The Dalmia-Jain Group was self-evidently not the only group which was known to have evaded taxes on a gross scale. To take two of the most obvious ones, as described in Chapter 4, there had been protracted correspondence over the Birla Group, in particular, their operations in West Bengal where the state government was unwilling to concede that the failure of efforts to identify evidence of widely surmised malpractices required deeper investigation using innovative means. More spectacularly, in what the Central Board of Revenue described as the biggest case of concealment in income in the history of tax collection, the board of Tata Sons, the managing agents of Tata Iron and Steel, were directly accused of conniving in enormous concealment of taxable income.

The crux of the argument of this book, however, is that these were straightforward cases of managing agents using loopholes available in accounting practices to lower the degree of taxable income chargeable to firms in their control. This practice, however reprehensible, is a normal characteristic of capitalist enterprise and the cat and mouse features of the attempts by the revenue authorities to identify the practices by which evasion is concealed a standard component of actual political life, and of fiction.9 What made the Dalmia-Jain practices qualitatively different was that they represented in quintessential form the unreconstructed activities of merchant capital and usurer capital operating through the legal forms of joint-stock enterprise and the institution of the managing agency. As the examples of their operations briefly outlined earlier show, they are characterized by a total absence of concern for industrial accumulation through manufacturing operations. Their utility lay in the possibilities of access to centralized blocs of capital, subscribed by a dispersed and managerially ineffective group of shareholders; the image the firms had earned as profitable and dividend-paying companies, for whom raising further resource would not be difficult; and the safeguards of limited liability, which ensured that speculative and extralegal operations remained within financially manageable bounds for their owners.

Given the vast array of economic offenses requiring the attention of the finance ministry, from political economy considerations, it was the correct decision to focus and examine Dalmia-Jain operations. This would enable the identification and prohibition of the parasitical operations of merchant capital in joint-stock industrial enterprises.

The momentousness of the step was shown by the decision after approval in principle by the cabinet to refer the matter to a cabinet subcommittee so as to enable the examination of the terms of reference, with the recommendations to be referred back to the cabinet.10 Significantly, it was decided that this subcommittee was to be chaired by the home minister, G.B. Pant, with the ministers of defence, works, housing and supply, food and agriculture, legal affairs, and V.K. Krishna Menon, then without a portfolio, as members. The composition of the sub-committee is an indication of the seriousness with which the matter was to be taken. After two meetings of the subcommittee, the cabinet approved the terms of reference of the commission in November 1956.11

However, while it is true that the home minister was probably the most appropriate choice, his proclivity to treat corporate misconduct benignly was displayed almost 20 years earlier. In a discussion of the amendments to the Companies Act in the Central Legislative Assembly, Pant had attempted to narrow the grounds on which a managing agent could be removed. This was opposed by the law member who asserted that the shareholders had the right to dismiss managing agents on any number of grounds and that limiting this would not

8 Letter no. 0159-PF/56 dated 15 May 1956 from the finance minister to Jawaharlal Nehru, JN Papers, File no. 441, p. 78. Nehru's concurrence with the procedure suggested is in the same file (Letter no. 172-PMH/56 dated 16 May 1956, p. 81).
9 Pages 9 and 30 of the petition by Shanti Prasad Jain quoted by Homi Daji, MP, in the course of the Lok Sabha debate on the motion, Re: Report of the Commission of Enquiry into Dalmia-Jain Companies, on 6 May 1963, col. 14030 of Lok Sabha Debates, 1963, vol. XVIII.
10 Minutes of the meeting of the cabinet held on Wednesday, 25 July 1956 at 5.30 pm, Case no. 180/39/56 on 'Alleged Mismanagement of a large number of Dalmia Group of Concerns', JN Papers, File no. 457, p. 353.
11 Letters nos 1702-PMH/56 dated 5 August 1956, and 1707-PMH/56 dated 6 August 1956 from Jawaharlal Nehru to Shah, and letter dated 5 August 1956 from S.P. Jain to Jawaharlal Nehru in JN Papers, File no. 462, pp. 42, 131, and 141, respectively. Minutes of the meetings of the subcommittee are in JN Papers, File no. 467, pp. 68–70 and File no. 470, pp. 13–43. The cabinet approval is in JN Papers, File no. 486, p. 120.
be in their interests. It may be of note that Krishna Menon did not attend either of the subcommittee meetings. Also, neither Nehru nor M.C. Shah, minister in charge of revenue and civil expenditure, were informed of the first meeting, though Shah, at Nehru's urging, was present at the second meeting. Soon after the cabinet meeting establishing the subcommittee, a Lok Sabha question asked for a confirmation of this fact, which was followed by a letter to Nehru from S.P. Jain. In this, he declared that after the split that had taken place in 1948, there was no such entity as the Dalmia-Jain Group. The Sahu Jain Group, which he was now in charge of, had no links with Dalmia. Consequently, he wanted an opportunity to explain that he was apprehensive of the undeserved adverse publicity that the investigation would entail. Nehru instructed Shah to meet Jain and hear his case.

THE MUNDHRA CASE: SHARE SPECULATION
AS A FINE ART

A year later Haridas Mundhra, who had successfully obtained control of British firms in the Calcutta area in the tea industry and engineering firms such as Jessop and Company, also wrested control of BIC. Expressing his anxiety at the ability of Mundhra to do as he pleased right under the nose of the Government of India, T.T. Krishnamachari,

12 Bombay Shareholders' Association (1949:49).
13 Starting in the tea export trade, Mundhra kept both the sales proceeds and profits in sterling in London, and used that to raise further finance in India. Gradually, he began buying British Indian companies such as Jessops, Richardson and Cruddas, Duncan and Stratton, the Brahmaputra Tea Company, and the Oslers Electrical Concerns, apart from a few collieries. However, the main appeal which he has—as a potential purchaser—in the British market is his preparedness to refrain from general interference with the internal workings of the companies he buys ... at least one big insurance company in the United Kingdom is prepared to support him ... it is difficult to see how he has been able to do all that he has without the knowledge of the U.K. exchange control authorities. The support which the U.K. exchange banks give him would necessarily mean at some stage or other a guarantee with the head offices of the exchange banks for Mundhra's loans in India and for that purpose some kind of approval or acquiescence by U.K. exchange controls, would be necessary. [Emphasis mine.] (Letter no. 084/PSF/55 dated at September 1955 from the finance minister to Jawaharlal Nehru, IN Papers, File no. 385, pp. 16–17)
See also India (1958a, 1958b) and Free Press Journal (1958).

minister for commerce and industry, asked C.D. Deshmukh, finance minister, to have procedures examined which would allow the government to examine the bona fides of an acquirer of any large block of shares in a company whose capital and other assets were valued at Rs 20 lakhs or more in then current prices.

Mundhra's large-scale acquisitions had reached the stage where they had attracted the attention of the US newsmagazine Time. A message, presumably about Mundhra and probably intercepted by the revenue intelligence authorities was forwarded to Jawaharlal Nehru who, mystified by the then unknown name, also wrote to C.D. Deshmukh to ask whether there was any material in the finance ministry about Mundhra's origins. Deshmukh's reply, sent three days later, was full of information, and given the importance of Mundhra to later events, is worth examining in detail. Mundhra was, according to Deshmukh's information, a 'self-made man', though as subsequent details show, with a considerable network of support, both in Marwari business circles and amongst the tea export traders. With finances of Rs 50 lakhs each provided by the firm of Bansilal Abhirchand of Nagpur and Vallabhbhai, a Vaishnavite guru from Rajasthan, he started with tea exports before the Second World War, subsequently building up his capital base in Britain by retaining both the sales proceeds and profits there. With this collateral, he was able to gain further resources in India, buying up not only Jessops but also Richardson and Cruddas, Duncan and Stratton, some collieries, the Brahmaputra Tea Company, and Oslers Electrical concerns. His most

17 Rai Bahadur Bansilal Abhirchand's firm had come to the notice of the Central Provinces Banking Enquiry Committee, which submitted a report in 1929-30. At that time the Abhirchand firm was the only indigenous bank in the province. It had eight branches in the province and seventeen outside. Although not operating under the Companies Act, it transacted business like modern banks, with payment by cheques. However, unlike banks, it also engaged in trade and advanced loans against the security of movable property. The Central Provinces Banking Inquiry Committee 1929-1930 Vol 1: 98, quoted in Levkovsky (1966: 239).
recent acquisitions were the Assam Tea Company and BIC. Through-out 1954 and 1955, Mundhra was in touch with large shareholders in the Assam Tea Company, and the resulting share price fluctuations were remarked on by the British financial press. The existing board of directors, as a defensive measure, had created a large number of shares worth one shilling each, with voting rights equivalent to the existing pound valued shares. Mundhra had been trying to obtain foreign exchange to finance the purchase of these shares, but Deshmukh claimed that his officials had been instructed not to allow foreign exchange outgo on this account.

In the case of BIC, although Mundhra had bought a small number of shares, the McRobert Trust owned the controlling block and Mundhra had worked hard to persuade the trustees in England to sell their holdings to him. The Singhania Group, which already held a substantial number of shares, was prepared to buy Mundhra's block if he was unable to persuade the McRobert Trust. With this, the Singhanias would have gained control. However, Deshmukh wrote, that very day's edition of the Statesman newspaper had reported that Mundhra had succeeded in his effort, on condition that he, in turn, did not sell off. Mundhra's own managing agency, the S.B. Industrial Development Company Limited, managed many of his acquisitions in name, but his main appeal as a potential buyer in the British market lay in his preparedness to refrain from detailed interference in his managed companies.

Mundhra had extensive support. One large British insurance company, at least, was behind his acquisitions. Even with all this, Deshmukh noted, and with his reputed 'phenomenal' luck, he could not have succeeded without the knowledge of the British exchange control authorities. British exchange banks would have required a guarantee from their head offices in London before extending loans to him in India and this could not be provided without approval or acquiescence of the exchange controllers. What was clear was that Mundhra had very satisfactory arrangements with the exchange banks and large overdrafts against the shares he lodged with them.

By the mid-1950s, Mundhra's wealth (presumably his personal assets) was reputed to be about 1-1.5 crore. Apart from the Vaishnavite guru, Mundhra was also rumoured to have access to the resources commanded by Shanti Prasad Jain, chairperson of the Punjab National Bank. He was also a 'bull' operator both for the shares of companies under his control and for those he wished to acquire. He was reputed to have a 'thoroughly dishonest attitude', and the judge who had disposed of one of his appeals concerning income tax matters in 1954 had gone so far as to record that, given Mundhra's past record, he would have used his discretion to refuse any writ filed by him.18

From Krishnamachari's and Deshmukh's accounts, it appears that at least three of the Marwari business groups, Dalma, Singhania, and Mundhra, with the support of a fourth business interest, S.P. Jain, were vying to gain control of major firms involved in the tea, textile, and engineering industries, in the vacuum created by the repatriation of British interests. There were several points of concern here. First, whatever the failures of the British managing agencies, there was a vast difference between their professionalism and that of the Indian groups who were engaged in taking them over.19 In fact, the differential quality of industrial management that the British and Indian managing agencies represented went beyond any normal range in capabilities. The Indian firms were either representative of trading and speculative capital (Mundhra) or, as in the other two cases of Dalma and Singhania, they represented capital accumulated through trade and usury, painfully attempting the transition to industrial capital, a transition made doubly difficult because of the constraints placed on industrial investment by the very recently concluded colonial period of India's history.

The consequences of such a pedigree were well described by Bettelheim.20 Basing his analysis on the Reserve Bank of India (RBI)–conducted All India Rural Credit Survey of 1951, he argued that an overlooked feature of the effect of the high rates of return to rural

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20 Bettelheim (p. 76) quotes the Majority Report of the Indian Central Banking Enquiry Committee (p. 99), which stated in 1931 that '...commercial banks ... occupy a significant place in the financial superstructure that is available to the village moneylender, the urban moneylender, the indigenous banker and the trader in agricultural produce'. Given that all the major groups had large-scale commercial banks within their fold, the link between '...big monopoly and financial capital with rural moneylending capital' was quite apparent to Bettelheim (p. 78) (Bettelheim 1957: 74–9).
moneymaking capital was the drain on urban capital stocks. This
differential was the cause of a continuous drain on newly formed
industrial capital, taking it not only into financial and commercial
operations, but also into the rural areas. This led to a situation where
capital accumulated in the industrial process was degraded into an
accumulation of debts—an extraordinary transformation of capital
into income in the hands of landlords and previous debtors.

Even if this flow could be reduced (by, for instance, the creation of
the State Bank of India with an extended network of rural branches),
there was the second point of concern for the State. This lay in the pre
dilections of these businessmen: rather than using their accumulated
capital in greenfield investments, they were engaged in the takeover
of existing companies. This practice enabled them to evade evolution
into industrial capitalists. Finally, and perhaps most dangerously, stock
market operations, explicitly visible in the case of Mundhra, were driv
ing the stock market forward and encouraging other businessmen
to similarly engage their resources in speculation on the markets.

The entire plan of industrial development which the Second Five
Year Plan was to lay out was threatened by these activities of private
capital. The 1948 Industrial Policy Resolution, soon to be replaced by
the more clearly focused resolution of 1956, had laid out new indus
trial areas which were open for fresh investment by the private sector.
It was within these bounds that private resources were expected to be chan
neled. For the representatives of merchant and usury capital, how
ever, widespread forms of pre-industrial capital—the traditional
textiles, sugar, and other light industry—were the preferred area of
activity. With capacity in large-scale cotton mills limited by the policy
measures designed to increase handloom production, acquisition
of existing firms in textiles, tea, and engineering, the last assured of
market demand by planned expansion of public sector activity, were
far more attractive, being known quantities with production processes
well understood and demand assured.

It was these considerations that led T.T. Krishnamachari to address
the finance minister only a couple of months later on the inexplicable
boom in the stock market. Curiously, the beginning of the boom
seems to have coincided with announcement of the ‘Socialist Pattern
of Society’ implying, perhaps, that the stock market realized that pri
vate industrial profits were going to rise in the foreseeable future.

However, Krishnamachari was apprehensive about the degree of
appreciation in share prices, which was qualitatively of a higher order
as compared to worldwide trends. Such an increase would mean, as
earlier mentioned, that fewer resources would be available to take
up shares in new companies floated in order to establish industrial
capacities in areas hitherto untapped. Krishnamachari suggested that
measures should be explored to channel investments into these newer
areas, possibly by asking banks through the Reserve Bank of India to
discontinue lending for investments in shares of existing companies.

It was not only British interests which were contemplating repatriat
ing their holdings in India. In a letter to T.T. Krishnamachari, G.D. Birla explained the mysterious circumstances by which he was
approached by ‘quite an important’ man, who, coming straight to the
point, wished to know whether Birla would be interested in buying
out Neville Wadia’s holdings in Bombay Dyeing, the major textile mill
in Bombay. The deal was to include the managing agency which
would be transferred to the Birla Group. From the trend of Birla’s
letter, it appeared that he was expected to show an interest and name
a suitably inflated price, which would then be used to bargain with
the Calcutta or Ahmedabad buyers who were reputed to have offered
double the then Bombay Dyeing share price of Rs 500. Birla report
edly advised the intermediary that if the Ahmedabad offer came from
Kasturbhai Lalbhai, that should be accepted as that would offer the
prospect of far better management than would be provided by the
Calcutta aspirers. Birla ended his letter by saying that he felt sorry
at the prospect of industrialists selling off their interests. Birla men
tioned Haridas Mundhra, Chiranjilal Bajoria, and Shanti Prasad Jain
as likely buyers who would pay a ‘fancy’ price but who were not,
previously, in his estimation, industrialists. He also expressed the
politically correct statement that at the age of 62, he wished only to
create employment opportunities and wealth, neither of which could
be realized by buying an existing company. This then was the defining

21 Secret letter dated 26 October 1955, copied to Jawaharlal Nehru on the same
date. TTK Papers, correspondence with Jawaharlal Nehru 1955, pp. 145–6.

22 Personal and confidential letter dated 17 February 1956, TTK Papers,
element of an industrialist, at least in that early period of industrial development in India.

Foremost amongst the capitalists whose outlook did not accord with those of industrialists were the jute mill owners of Bengal. T.T. Krishnamachari had remarked, nearly three years earlier on the Marwaris being 'notoriously indifferent to the efficient working of the industrial apparatus, mechanical as well as human'. This was in one of the earliest expressions of concern about the consequences of British interests selling out to the Marwaris. This was a colourful yet acute portrayal of the attitudes of representatives of merchant and usurer capital to issues of industrial management, plant maintenance, and modern systems of industrial relations. As Nehru noted, even B.C. Roy, chief minister of West Bengal, and no 'socialist' ideologue, had spoken rather strongly about the jute mill employers and felt that steps should be taken to make them behave. This was presumably a reference to their cavalier attitude, along the lines of absentee agrarian landlords, towards laws regulating labour conditions in their plants.

To summarize the situation as it appeared to the Government of India at the beginning of the Second Five-Year Plan, businessmen who had accumulated large funds through grey areas of economic activity had found that the stock market, buoyed by the prospects of high returns to industrial investment, was a source of high short-term returns. Simultaneously, established British industrialists and even some Indian ones, whether motivated by fatigue or uncertain prospects within a controlled economy, were keen to liquidate their stock market-based assets. There was then the prospect that well-established and well-managed firms would fall into the hands of unknown figures, some of whom had the reputation of being adventurers. Apart from their own proclivities on the stock exchange, their manipulation of the market through insider trading was proving a lure to other capitals which might have been invested in new enterprises. With ambitious plans for private investment, the Government of India could not be indifferent to these phenomena.

**SOCIAL ENGINEERING THROUGH FISCAL POLICY**

Even before he became finance minister in September 1956, Krishnamachari was playing an important role in introducing innovative ideas into Indian fiscal policy. After a meeting with Nicholas Kaldor in March 1956, he wrote to Jawaharlal Nehru mentioning that he agreed with Kaldor that the existing taxation system took no account of human factors and presumed that by increasing the rate of tax the desired redistribution would take place. He also emphasized that Kaldor's proposals, with which he was familiar, having read his book on expenditure tax and his minute of dissent to the British Royal Commission on Taxation, formed parts of an integrated scheme and could not be introduced piecemeal. However, given the novelty of the scheme, Krishnamachari felt that considerable propaganda efforts would be necessary, both with MPs and within the Congress. He asked Nehru if he was agreeable to have a meeting in the Lok Sabha, to which Nehru agreed.

Two months later, when a group of Congress MPs submitted a memorandum on taxation policy, a copy was sent to Krishnamachari. The substance of their argument was that with the adoption of the 'socialist pattern of society' (by both the Congress and the Lok Sabha), the recommendations of the Taxation Enquiry Commission had been made obsolete. So the proposal to tax basic items

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24 Letter no. 605-FMO/56 dated 17 November 1956, to Khandubhai Desai, labour minister, JN Papers, File no. 485, p. 34.
25 Deshmukh in his letter to Jawaharlal Nehru referred to Mundhra as someone willing 'to take risks—and heavy risks involving his personal fortune too...' (Secret letter no. 084/PSF/55 dated 21 September 1955, JN Papers, File no. 385, pp. 16–17).
27 Confidential letter no. 115-OMO/56 dated 15 March 1956. TTK Papers, correspondence with Jawaharlal Nehru, 1956, p. 40. It was presumed by both that C.D. Deshmukh, the titular finance minister, would be consulted only as regards the details of the meeting.
29 The actual resolution referred to a 'socialistic pattern'. The distinction is important as there was opposition within the Congress to the full-blooded term 'socialist', but these MPs, on the left politically, probably wanted to assert themselves.
of consumption in use by the poor, so as to raise resources for the Plan, was not valid. The group presented a list of items which they indicated should not be taxed, but measures taken to ensure stable prices prevailed despite resort to measures of deficit finance. For this, not only price controls, but also a system of buffer stocks in strategic locations had to be established. The resources foregone because of the exemptions on tax of these basic items could be balanced by increasing taxation levels of the higher income groups, whose income and wealth would necessarily increase with a 'high pressure development programme'.

Concerned by the implications of these trends in economic ideology, the World Bank took the opportunity of Krishnamachari's formal appointment as finance minister to deliver a few home truths. Emphasizing that it was his conviction that India's interest lay in giving private enterprise, both Indian and foreign, every encouragement, Eugene Black, president of the World Bank, disparaged the intrusion of ideology into policy matters. He singled out the Industrial Policy Resolution in this regard, and argued that the targets for public sector investment were far too large. The deficit financing necessary to support this investment were sure to lead to unacceptable inflationary pressures and create financial instability. As far as external finances were concerned, the bank wanted a change from the existing policies that discouraged exports of textiles and vegetable oils to the active support of these and other traditional exports.

Reiterating the bank's willingness to support India's plan, Black cautioned that the quantum of aid would necessarily depend on India's success in attracting foreign investment (phrased as '... external financial assistance ... [which did not entail] ... fixed foreign exchange commitments'). A specific area of policy reform, with which the letter ended, noted that Indian reliance on the expansion of the rail network, while welcome, should not ignore the importance of road and coastal shipping, a problem of transport 'which has particularly engaged the attention of the Bank, as well as of your own Government and of private interests throughout India'.

The impact of this letter was evident a short time later, when the cabinet met to consider the subject of the financial resources required for the Second Five-Year Plan. The terse minutes merely recorded that after consideration of a finance ministry paper on the subject, there was broad agreement on the approach. However, it was decided that for the time being only the three proposals of a capital gains tax, an increase on tax rates on dividends, and controls on companies' reserves were to be implemented.

This was certainly a retreat from Kaldor's integrated scheme. However, the significance of the controls on the use of reserves by companies needs to be emphasized. From the 1930s, observers had noted the tendency of managing agencies to use these reserves as cheap sources of finance for a variety of purposes, with the concomitant that depreciation reserves were perpetually inadequate to meet replacement costs, particularly at times of technological change, or even of unusual levels of inflation.

Because of considerations of maximizing internal supplies but because of the regional concentration of the industry and the political issue of supporting particular groups of industrialists at the expense of others. If this was also true of vegetable oils, another regionally concentrated industry, this would amount to a serious indictment of the political management skills of the cabinet. It is significant that in an undated note in 1979, Krishnamachari suggested to the commerce and industry, food and agriculture, and steel, mines, and fuel ministers that distribution and export organizations should be established on a statutory basis for the sugar, textiles, cement, and iron and steel industries (TTK Papers, correspondence with Jawaharlal Nehru 1956, n.p.).

Meeting of the cabinet held on Thursday, 15 November 1956, at 9 am, Financial Resources for the Plan, Case no. 308/66/66, JN Papers, File no. 488, p. 204.

See, for instance, Samant and Mulley (1937: 167).
be utilized for upgradation of plant and equipment would not be eligible for tax rebate was an important step in social engineering, discouraging non-industrial forms of utilization of company resources.

Another controversy that erupted at this time was that created by the resignation of the RBI governor, B. Rama Rau. The substantive issue was the government's proposal to increase the stamp duty levied on money market transactions. The RBI felt that the large increase in stamp duty, a "fiscal measure with monetary implications" in Krishnamachari's words, infringed on the prerogative of the bank to determine monetary policy. Apart from the government's action, Rama Rau was also incensed at the characterization of the bank as a department of the government and offended at Krishnamachari's personal behaviour towards him. Nehru supported Krishnamachari, and various commentators have noted and generally deplored the era of subordination of the RBI to the government that this episode inaugurated. What has not been remarked on is the fact that this institutional subordination was the expression of the primacy given to industrial policy over monetary policy. As a measure of social engineering, this was even more critical than the controls on reserves. Basing himself on the empirical results of the RBI's All India Rural Credit Survey,

35 The Reserve Bank's view of these developments is in Balachandran (1998: 715-24). While this account is largely framed as an account in interpersonal and inter-institutional issues, later, on pp. 729–30, Balachandran comes close to the present discussion, although it is framed in a Keynesian-cum-structuralist-cum-'modernist' versus monetarist policy perspective. The present account is also based on the following documents—JN Papers, File no. 494: Secret and immediate letter no. 286-PMH/56 dated 6 December 1956, from Jawaharlal Nehru to T.T. Krishnamachari, p. 157; Secret letter no. G.8-300/56 dated 10 December 1956, from B. Rama Rau to H.M. Patel, enclosing Secret memorandum no. 3-34, Memorandum to the Central Board Implications of Certain Provisions of the Finance Bill, 1956 dated 10 December 1956, pp. 72–6; Letter dated 11 December 1956, from T.T. Krishnamachari to Jawaharlal Nehru, p. 177; Secret letter no. 689-PMO/56 dated 12 December 1956 from Jawaharlal Nehru to B. Rama Rau, pp. 307-8. Also JN Papers, File no. 498, Secret letter no. G.8-31/56 dated 29 December 1956 from B. Rama Rau to Jawaharlal Nehru, pp. 103–8 with enclosure 'Extract from the statement by Shri B. Rama Rau, Governor, Reserve Bank of India, at the Bank Annual Report Discussion (25 September 1956) on p. 101.

36 It is significant to note in this context that thirty-five years later, the Economic Survey of the Ministry of Finance for 1992–3 noted explicitly a reversal of this situation: henceforward, industrial policy would be complementary to trade, fiscal, and exchange rate management policies.

Bettelheim had remarked on the large difference between the interest rates in the urban money markets and those in rural moneylending (the bank rate rose to a maximum of about 5 per cent in 1958 as compared to agricultural moneylending rates of between 25 per cent in Bihar and 40 per cent and above in Bengal, Orissa, and Himachal). The tightness of the money market and requests for steps to ease controls were one, constantly repeated, theme in all of G.D. Birla's correspondence with Krishnamachari. Shrewdly, he linked the market conditions affected to the difficulties it created in financing industrial expansion plans.

THE MUNDHRA EPISODE

The resignation of T.T. Krishnamachari from the finance ministership in early 1958 was the culmination of three developments that evolved concurrently, but were distinct in their historical significance. The first was the actual sequence of events that led to Jawaharlal Nehru accepting Krishnamachari's resignation. This has been detailed in the public record, in the open proceedings of the M.C. Chagla Commission of Enquiry and notably, in G. Balachandran's account in the volume of the history of the RBI authored by him. The second, little noticed, is the way in which the 'Mundhra episode' was media-managed with the encouragement, if not at the behest, of industrial interests who found that the controls established as part of the industrialization drive accompanying the Second Five-Year Plan...
Plan made serious and unacceptable inroads in private capitalist decision-making. These were felt to be of an order that justified, in their minds, a multi-pronged political response, as will be seen. The third development, involving social engineering, was a concerted effort to push the bearers of merchant and usurer capital towards industrial capital norms. It will be argued that it was an uneasy coalition formed by opponents of each of these developments that coalesced and led to Krishnamachari's resignation.

In May 1957, as large quantities of shares of the Mundhra firms were held by commercial banks in the country, including the State Bank of India (SBI) and several exchange banks, H.V.R. Iengar, governor of the Reserve Bank had convened a meeting to take concerted action to prevent a sudden or haphazard unloading of these shares on the market.42 However, this meeting was abortive and by June 1957, Mundhra was in serious trouble. He had approached G.D. Birla for help in liquidating a part of his holdings, but Birla felt that with the tight conditions in the money market no one would be prepared to buy the shares. Birla suggested that Mundhra should meet Krishnamachari and ask for his advice.43 By this time, the Punjab National Bank, which had been accommodating Mundhra, was pressing him to repay and Birla felt that Mundhra risked losing control of Turner Morrison.

Following a further meeting between the SBI, Life Insurance Corporation (LIC), and T.T. Krishnamachari in June, it was decided that LIC would attempt to reduce the pressure of the market by buying a large block of Mundhra's shares. The proposal was conceived as a short-term measure to maintain share prices in the market but this step proved incapable of restoring confidence in the share market.44

Later in the year, SBI and LIC, both with very heavy stakes in the matter, had reviewed the situation and, in consultation with Krishnamachari, had agreed that SBI should take urgent action.45 In November 1957, it was the turn of H.V.R. Iengar, then governor of the RBI, to report to Krishnamachari. The managing director of BIC was reported to have confided to Sachin Chaudhuri, member of the SBI's Calcutta local board, that in payment for dues from Mundhra's mills, BIC had received Richardson and Cruddas shares. These shares had been supposedly held by the Punjab National Bank which had sold them. However, confidential enquiries with the bank showed that the endorsement for transfer had been forged; the shares neither belonged to the bank nor had they transferred them. The managing director of the BIC had lodged the shares in safe custody and Mundhra was now demanding that they be returned. Although both the SBI and the LIC were taking steps to ensure the security of their advances and investments in Mundhra's various firms, Iengar felt that the time had certainly come to stop Mundhra in his share certificate forging orgy.46 Iengar followed with another letter two days later, informing Krishnamachari that the managing director of BIC had also lodged the share transaction form with the SBI, with an RBI lock installed for double protection. In the meantime a large block of Mundhra's shares pledged to the Punjab National Bank were offered for sale because Mundhra had not been able to pay his dues and his cheques were not being honoured. It was uncertain how many of these shares were forged.46

Events moved quickly after this. On 5 December, Iengar wrote to say that LIC and SBI would jointly present a petition asking the court to appoint a manager for Richardson and Cruddas BIC, which were to be taken possession of under the hypothecation agreement they had entered into.47 A criminal case was to be filed concerning the forged shares in the possession of the Punjab National Bank. Finally, an investigation under the Company's Act was to be initiated into the affairs of all the Mundhra companies. In his secret note, D.L. Mazumdar, then Secretary, Department of Company Affairs, added that LIC was also keen to change the management of Jessop and Company and was seeking the cooperation of other large shareholders, Punjab

42 Letter dated 8 June 1957, TTK Papers, correspondence with G.D. Birla, pp. 78-80.
43 Secret note by D.L. Mazumdar, TTK Papers, Subject file 21, p. 50.
44 Secret note by D.L. Mazumdar, TTK Papers, Subject file 21, p. 51.
National Bank and the engineering firm Burn, Brathwaite, Jessop and Co.48 If this cooperation did not materialize, LIC wished to take action under the Companies Act with its 20 per cent shareholding, but it was felt that no minority shareholder could bring about a quick and non-disruptive change in management. Mazumdar also reported that he was informed that at the time when LIC came to Mundhra's help in June 1957, no special powers of intervention had been sought from Mundhra, so that if the situation did not improve, LIC could decisively intervene in company management. In the event, before the Mundhra case became a cause célèbre, the Department of Company Law, SBI, LIC, and RBI had agreed on the takeover through court action of the management of BIC and Richardson and Cruddas, police action against the share forgeries, and an investigation into the affairs of the Mundhra companies by the Department.49

In the context of the controversy over the LIC purchase of the Mundhra shares, whether the shares should have been bought from Mundhra himself, or whether Krishnamachari or H.M. Patel browbeat the chairman and managing director of LIC to buy these shares against their better judgement, the most critical factor seems to have fallen by the wayside. This was emphasized by a comparison of the two notes written by D.L. Mazumdar, secretary of the Department of Company Law Administration in September 1957 and the second in December 1957. The first was addressed to Jawaharlal Nehru, at the time when Krishnamachari was in the United States.50 Pointing out that the share purchases by LIC seemed not to have had any lasting results, with the share prices continuing to fall, Mazumdar suggested two options to the government. The first was an investigation into the affairs of the Mundhra Group under provisions of the Companies Act; the second was action against the management of specific companies of the group for contravention of articles defining sound principles of corporate governance. Mazumdar suggested that any process of formal investigation would be long-drawn-out, subject to judicial scrutiny, and would be detrimental not only to the 'interests of investors but also of employees and, indeed, of production as such. As for action against specific companies, the department was considering feasible action.

Curiously, the note did not suggest the takeover of at least those companies in the group in which the SBI had a decisive stake through the hypothecation agreements accompanying the loans advanced to both the BIC and Richardson and Cruddas, a step that was taken finally, three months later. Similarly, the provisions under the Industrial Development and Regulation Act (IDRA), allowing action by the government in the public interest, were not considered at any time. According to Mazumdar, it was the evidence of Mundhra's widespread use of forged share certificates which made the governor of the Reserve Bank feel that urgent action was demanded. It was also the combined resolve of the RBI, SBI, and LIC that led to the agreement by Krishnamachari in late November of these initiatives to gain managerial control.

What is being suggested is that in a long-term historical perspective, the issues that gained public attention at the time of the Mundhra episode were irrelevant. The question that needs to be asked is why these steps could not have been taken earlier. The conventional reasons offered, both by the commissions of enquiry and later commentators, of a short-term nexus between Mundhra as an individual and the Congress Party's requirements of funds for the 1957 elections seems inadequate.51 As has been mentioned, Mundhra had long-standing connections with the British exchange banks and even with the British Government. The significance of the reluctance of Mundra's creditor banks to take combined action to protect their own interests at the meeting called by the RBI governor in May 1957 has already been noted. Also, there was the marked reluctance of the Punjab National Bank, which, together with the LIC, was a major shareholder in BIC, to initiate police action even when it was discovered that the share certificates it held as surety were forgeries. It will be recalled that the then chairperson of the bank, Shanti Prasad Jain, was one of the persons under scrutiny in the Dalmia Jain case. What is then suggested is that action to divest Mundhra of control of his companies, until a stage was reached where action became imperative, was actively

49 Secret note by D.L. Mazumdar, TTK Papers, Subject file 21, p. 56.
discouraged because Mundhra belonged precisely to the category of short-horizon businessmen who were so entrenched in the political economic nexus that presided over at least a significant part of the Indian political economy.

If this was indeed so, then a more promising area of enquiry is raised by the brief mention of the controversy surrounding Mundhra in the Salivati Newsletter, a broadsheet published from Bombay and evidently in the know of Bombay share market gossip.\textsuperscript{52} According to this account, in March 1957, the Union commerce minister was alerted by the chief minister of Uttar Pradesh to the accumulation of stocks at the BIC mills and the imminent threat of closure of the mills leading to unemployment of 20,000 workers. After a visit to Lucknow and discussions with the chief minister and Mundhra, Union government officials advised Mundhra to reduce the labour force by dismissing a section of workers. He was also offered financial help, but after the refusal of the National Industrial Development Corporation, the SBI, and the exchange banks to advance further funds, attention was to focus on LIC. According to the Salivati Newsletter's sources, between four and six members of the Union cabinet were in favour of extending financial help to Mundhra and, quite contrary to the predominant view that the financial improprieties were the result of a series of ill-considered and unsound directives issued by Krishnamachari, it was held that actually he was guilty of an inability to withstand the pressure from his cabinet colleagues and was merely an instrument in the decision that LIC would purchase the shares.\textsuperscript{53}

OPPOSITION TO THE SOCIALIST PATTERN:
THE FORUM OF FREE ENTERPRISE AND THE
DEMOCRATIC RESEARCH SERVICE

Almost simultaneously with the adoption of the resolution on the socialistic pattern of society in January 1955, and its endorsement by the Lok Sabha soon afterwards, Bombay businessmen began to voice their dissatisfaction with the trend in economic policies. As a result, the government agreed to a series of consultations with major figures in the industrial field. In 1955, the major concern was the Companies Act, and a meeting was held with the Congress president, U.N. Dhebar, Morarji Desai, chief minister of the then Bombay state, G.D. Birla, J.R.D. Tata, and Gujarmal Modi amongst others. The discussion began with a general discussion about the socialist pattern. While both Tata and Modi were very gloomy and felt that the future held out little hope, Birla and some others took the line that adaptation to changing conditions and acceptance of major policies laid down by the government was essential if private industry was to function properly. Ultimately, both Tata and Modi, though probably not wholly convinced, toned down their criticism.\textsuperscript{54}

By February 1956, with the imminent announcement of the new Industrial Policy Resolution, the feelings of apprehension were quite apparent to G.D. Birla, who reported the mood at a lunch hosted by Tata. Birla's attempt to inject some optimism apparently entirely failed.\textsuperscript{55} Led by the Tata Group these misgivings materialized in the Forum of Free Enterprise.\textsuperscript{56} According to its manifesto, which was published in the Bombay edition of the Times of India in July 1956, the forum was to be a non-political and non-partisan organization, disseminating authoritative information to educate public opinion on the achievements of private enterprise, and the manner in which it could contribute to the economic development of the country.\textsuperscript{57} It called for support from those in service, profession, agriculture, trade, and industry. However, in its far-flung effort to explain the purpose of its establishment, A.D. Shroff, one of its chief organizers, clarified that the forum would have its political activity in the shape of

\textsuperscript{52} Salivati Newsletter, published from Bombay, vol. 1, no. 35, 27 December 1957, JN Papers, File no. 580, p. 66.

\textsuperscript{53} It is significant that Balachandran gives some credence to the opinion that Krishnamachari's decision to deny any knowledge of the LIC deal at the public hearings conducted in the course of the Chagla Commission was on the advice of the home minister, G.B. Pant (Balachandran 1998: 802).

\textsuperscript{54} Confidential letter no. 355-FMO/55 dated 18 August 1955 from Jawaharlal Nehru to C.D. Deshmukh, JN Papers, File no. 371, p. 194.


\textsuperscript{56} Kochanek (1954) discussed the Forum of Free Enterprise in some detail. See pp. 204–8. A.D. Shroff's presentation reported in 'Minutes of the Meeting of the Departmental Heads of Tata Companies convened by the Chairman on the 23 April 1957, TTK Papers, Subject file 10, pp. 13–15.

\textsuperscript{57} Top secret note, 'Forum of Free Enterprise', undated, JN Papers, File no. 485, p. 972.
organizing public opinion against the government’s economic policy, including the threat of nationalization implicit in the takeover of the airlines, the Imperial Bank, and the life insurance sector. The 1956 Industrial Policy Resolution was responsible for creating apprehensions in businessmen’s minds, as also in the minds of middle class investors.\textsuperscript{58} M.R. Masani, founder of the Democratic Research Service, spoke more explicitly at Bangalore: lovers of freedom, he said, should be alert enough to shift their fire and their aim from one source of the centralization of power and privilege to another.\textsuperscript{59} In his opinion, the social forces represented by industrial management, trade, organized labour, the professions, industrial proprietors, and religion could provide the checks and balances necessary to curb power. Morarji Vaidya, president of the Indian Merchants’ Chamber, in an article in the *Times of India* criticized both the nationalizations, but extended the basis for opposition by referring to the ‘attitude’ adopted by the State Trading Organization.\textsuperscript{60} Further activity was reported: contact was established in the course of five meetings in July 1956 with 120 trade organizations in Bombay, with 50 members of parliament in Delhi in September 1956, with members of the Mysore Chamber of Commerce and the Indian Institute of Culture at Bangalore, also in September.\textsuperscript{61} Meetings in Calcutta were held with prominent citizens, with the Upper India Chamber of Commerce in Kanpur, and the Gujarat Chamber of Commerce in Ahmedabad. Finally, an All India Essay contest was organized for students on the subject “Free Enterprise and Economic Progress”, and, under the auspices of the magazine *Trend*, a meeting for women was held at the Taj Mahal hotel, where the audience was reminded that as consumers of domestic goods, they provided adequate regulation of the industry, thereby making state regulation superfluous.

So as to make the aim of the forum plain beyond any doubt, according to another intelligence report, A.D. Shroff, speaking to the Commerce Graduates Association in October 1956, referred to the letter from Eugene Black, president of the World Bank, to T.T. Krishnamachari, criticizing the direction of recent economic policy. Black was, according to Shroff, a ‘real and sincere’ friend of India. By December 1956, the ambitions of the sponsors of the forum, perhaps fortified by the response to their campaign, had extended to the overtly political. Japan Singh, an MP of the Jharkhand Party, was approached to gain his support for the candidatures of M.R. Masani, A.D. Shroff, H.P. Mody, and Leslie Sawhney, J.R.D. Tata’s brother-in-law, in the 1957 parliamentary elections from the Jharkhand area of Bihar.\textsuperscript{62} Tulsi das Kilachand, another industrialist-MP, had joined the ‘Tata crowd’ who were simultaneously in touch with N.C. Chatterjee, extending support to fifteen candidates in constituencies where the Hindu Mahasabha and Jan Sangh had a political base. The Democratic Research Forum and the Forum of Free Enterprise, having collected Rs 10 lakh, were in need of more money. A political attaché in the US Embassy, ‘...working directly under the orders of Mr. Allen Dulles...’ (director of the CIA) had offered considerable financial assistance from secret service funds.\textsuperscript{63}

Apart from the broader relevance of these developments to India’s political trajectory and the increasing pressures towards modifying economic strategy, by April 1957, it was clear that the immediate target of attack was T.T. Krishnamachari. H.V.R. Lengar informed Krishnamachari of a conversation he had had with Shroff.\textsuperscript{64} To a query about


\textsuperscript{60} Top secret note, ‘Forum of Free Enterprise’, undated, JN Papers, File no. 485, p. 96.


\textsuperscript{62} It is interesting to note that it was G.D. Birla who suggested to H.P. Mody, in February 1956, that if he wished to contest the Lok Sabha election, he should stand from an area near Jamshedpur, rather than from Bombay. Personal letter dated 28 February 1956, from G.D. Birla to T.T. Krishnamachari, TTK Papers, correspondence with G.D. Birla, p. 36.

\textsuperscript{63} Personal note by M.O. Mathai dated 1 December 1956, JN Papers, File no. 493, p. 29. Nehru sent the substance of this note to U.N. Dhebar, Congress President, in his secret letter (no. 665-PMO/35 dated 6 December 1956, File no. 494, p. 121). In a secret note to the secretary general of the ministry of external affairs written on the same day (to which, significantly, he attached a copy of Mathai’s note), he suggested that at the impending talks with the US Government ‘some general reference might be made to these reports of American funds being offered for election purposes here’ (File no. 494. p. 109).

\textsuperscript{64} Strictly personal letter dated 4 April 1957, TTK Papers, correspondence with H.V.R. Lengar, p. 10.
whether Shroff was aware that he was doing a great deal of injury by the reckless manner in which he was attacking the government; Shroff immediately turned the conversation towards Krishnamachari personally, and to his supposed open hostility even to any legitimate criticism of his policies. While reiterating that Shroff’s idiosyncrasies were well known to Krishnamachari, Tendulkar warned that the broader intent of Shroff’s criticism was being shared with some of his colleagues in the cabinet. This aspect of Shroff, of allowing bitterness towards policies affecting him in relation to unrelated areas of government’s functioning, was noted by Nehru too.65


After the presentation of the 1957 budget, it seemed as if the campaign to create a fear psychosis amongst the middle class had reached such proportions that Nehru, while strongly reiterating his support for the fiscal measures, had to warn Krishnamachari of the prevailing current of opinion.66 Almost simultaneously, Krishnamachari was told by the old established Congressmen and the then governor of Bombay State, Sri Prakasa, of his own misgivings about the budget proposals.67 Sri Prakasa specifically pointed towards the opportunities for harassment, not only directed at businessmen but also to the middle class who would, reportedly, be required to maintain records of expenditure. In the fortnightly report that state governors were to send to the president, Sri Prakasa elaborated his concerns, a copy of which he sent to Krishnamachari. On his part, Nehru pointed out that it was the business of government, without sacrificing its principles, to carry every shade of opinion with it. He emphasized that even when a policy was opposed by clearly sectional interests, it was important to ‘...hurt ... [the individuals involved] ... as little as possible, that is, to put it ... [crudely, to deal with the problem] ... in a politician’s way’. Not only had the Congress party in the Lok Sabha to be taken along in support of these measures, but the people generally, ‘Running down’ of the propertied classes, though often justified, ended in demoralizing not only them, but also the large middle class and even the lower middle class.

In his reply to Nehru’s letter of warning about the currents of opposition created by the 1957 budget, Krishnamachari made an astute point.68 While agreeing that all the major moulders of public opinion in the press were sharply critical of the fiscal measures proposed, Birla was singled out as a friend. But even: ‘he feels hurt because the prospect of running the type of business as he has been doing in the past will not be possible in the future’. While Birla could adjust to the new circumstances, other businessmen, presumably deeply enmeshed in the usurious, speculative, and commercial modes of operation could not easily do so. According to Krishnamachari, Birla was thus torn between his loyalty to the Congress (his friends) and to his ‘clan’—this latter breed of businessmen.69

Where Krishnamachari’s shrewdness seems to have failed him was in his unwittingly creating an alliance between Birla’s ‘clan’ and the modern Bombay-based supporters of the Forum of Free Enterprise.70 While the former reacted to his measures of social engineering, the latter objected to the institution of controls that, in their opinion, impinged on their sources of authority and power. Together, they created the situation that forced Krishnamachari’s exit from the cabinet.

After the 1962 elections, Nehru offered a re-elected Krishnamachari any cabinet post of his choice except finance (held by Morarji Desai after a brief interval following Krishnamachari’s resignation in 1958). In a bitter letter to Nehru, Krishnamachari claimed that it was Morarji Desai who had played a major role in ensuring a situation in which his resignation became inevitable. His charges were formidable:

69 Kochanek (1974), dealing with the situation within the Federation of Indian Chambers of Commerce and Industry (FICCI) in the mid-1960s, has an interesting discussion on the size of Birla’s ‘clan’ (pp. 170–93).
70 Kochanek (1974) has discussed these differences on p. 216 and pp. 220–2.
...you are a mature politician and the Prime Minister of a great country. In the course of the discharge of your obligations, therefore, it does happen that you might have to walk over the corpses of your friends. I realize it might be necessary & I for my part have no grievance. But I cannot be a good friend and unilateral though it might be I consider myself to be one ... if I did not tell you that you do wrong. It is for you to decide whom you are keeping as helmsman of the economic affairs of this country. You will appreciate also that I cannot serve in any ministry charged with some economic mission with the present FM as economic director. There are two angles to it—one personal and the other a matter of principle. Mr. [orarji] D[esai] had a fair share in the launching of the campaign against me when I was [finance] M[inister]. I know more of it after I left. His minions in the Lok Sabha & outside did the dirty work. You know that he brought Moulana [Abul Kalam Azad] into it at one stage. He suborned the loyalty of officials whom I had trusted & even specially favoured by offers of preferment and made them give false testimony before the [first] Vivian Bose Commission. His agent[,] a journalist at the time[,] lobbied with the UPSC and got rewarded as news editor in [All] [India] [Radio]. The nasty speeches in the discussion on Bose's report etc. were made by his agents—known to be such to all members of the Lok Sabha. On the public issues he was the apostle of all that I was against. The Finance Ministry has become a veritable paradise of the vested interests these last few years. My tax measures were drastically amended & such that remain have been made dead letters administratively...I hear that the Central Board of Revenue has been asked to prepare a paper supporting a scheme to abolish the wealth tax & expenditure tax. Tax evasion during these four years has gathered momentum and officials are afraid of Bombay vested interests ... The Swatantra Party against which you have been fighting is not really led by Rajaji [C. Rajagopalachari] but by the big guns of industry & trade and the FM & another in your cabinet are their firm supporters. At the appropriate time they would change the band wagon...71

The message of this emotional outburst was clear: the era of social engineering through innovative fiscal measures was over and private enterprise would increasingly set the terms on which it wished to negotiate with the government.


CHAPTER SEVEN

Denouement

The Final Abolition of Managing Agencies

The commission of inquiry appointed by the government to examine the operations of the Dalmia-Jain Group submitted its report in 1963 after delays due to court cases filed by the Dalmia-Jain Group, which were first heard and dealt with. The report was the subject of extensive debate in the Lok Sabha, where the members generally responded to the revelations contained in the commission's report with a degree of resignation. The methods by which the group had defrauded shareholders and the government might have been new in detail, but the MPs were evidently at a loss on how precisely these practices were to be prohibited. Shanti Prasad Jain's plea that his group had only employed the same procedures that were common to big business operations neatly summed up the situation, although this was not an accurate description.7 As has been suggested earlier, by using the frame of joint-stock companies as a means to aggrandizement, the group had behaved in a qualitatively different way to the 'straightforward' cases of tax evasion of Tatas, Birlas, and even the stock market speculation of Haridas Mundhra.

When the report on the Dalmia-Jain Group was released in 1963, its quite startling revelations gave pause to even those members of the government long inured to the ways of the business world. Its implications were such that Krishnamachari, finally back in the cabinet, felt that a carefully chosen official would need to be appointed to examine the report and suggest remedies. He feared that the forces which would oppose action were so powerful and resourceful that nothing might conceivably be done at all. D.R. Gadgil, in an unsigned note in response to a request from Pitambar Pant, head of the perspective planning division of the Planning Commission, set out in clear terms the reasons why the controls instituted by the government had failed to deal with determined efforts to prevent activities which, though not technically illegal, had serious implications for society.

The problem posed by the findings of the Commission may be described as follows. It has been found that a group of businessmen has acted together in the past, in all kinds of devious, patently unfair or even illegal ways and has, as a result, not only made large gains for its members, but has enabled them to attain to such dominant economic position that a part of the old group, as such, and most of its members individually, today are amongst the most powerful and prosperous of business concerns and businessmen in India.

Discussing the possible ways of preventing similar legislative enactments in the future, Gadgil argued that the two principal legislative enactments, the Industrial Development and Regulation Act (IDRA) and the Companies Act, were inadequate to deal with such situations. The Industrial Development and Regulation Act was framed so as to promote industrial development, to maintain continuity and efficiency in production, and for the conservation of resources. Only one subsection, added in 1953, enabled the government to initiate an investigation when any enterprise was seen to be managed in a manner highly detrimental to the industry as a whole, or to public interest. However, Gadgil noted, the addition of this subclause had not made any difference to the rest of the act; public interest remained a fifth wheel in the structure of the act. In the case of the Companies Act, Gadgil pointed out that following the example of British Company Law, the Indian act abstracted from economic policy and, more critically, the courts in India had examined proposals for corporate action that came before them in a narrow framework, and public interest again was entirely absent in their consideration of a case. Turning to international experience in dealing with economic offenses of the Dalmia-Jain type, Gadgil pointed out that only in post-war West German legislation did offences include those which ‘violate[d] the interest of the State in the conservation and integrity of the economic order as a whole or in individual branches’. Moreover, he added, in relation to this new classification of economic offence, the measurement of the gravity of the offence was also innovative: the yardstick was not only the gravity of the interest that had been injured, but also the mens rea (degree of criminal intent) of the offender.

Gadgil concluded that the sphere of action by which such cases could be prevented was not that of legal remedies. Only when public interest was invoked and the approach defined as that relating to the totality of the economic system that a solution to halt, if not reverse, a ‘steadily worsening situation’ would be possible. Concretely, he suggested that the group’s managing agency control over public companies should be forcefully broken, there should be expropriation of the assets of the group, and the firms under their control should be taken over by the government. Finally, the persons indicted were to be prohibited from holding office in any joint-stock company whether closely or widely held.

Despite the generalized revulsion of Dalmia-Jain business practices expressed in the Lok Sabha debate, the supporters of the managing agency system fought a determined rearguard action. When the Managing Agency Enquiry Committee was announced by the

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2 Letter no. 49/MEDC/63 dated 28 January 1963 to Jawaharlal Nehru, TTK Papers, correspondence with Jawaharlal Nehru 1963–4, p. 22.
4 Gadgil note, p. 3.
5 Gadgil note, p. 2.
7 Gadgil note, pp. 3–4.
8 This was apparent from the publicity given to the special pleading on behalf of the Dalmias contained in documents such as Mittal et al. (1963?).
government in 1966, it was asked to confine its attention to the utility of the system to enterprises in 'established' industries. The appointment of such a committee was mandatory if action had to be taken under Section 324 of the Companies Act, which enabled the government to ban managing agencies in specific industries. It will be recalled here that the Imperial Chemical Industries (ICI) had objected to Kasturbhai Lalbhai's insistence on a managing agency for the joint venture with Atul Products. As is well known, almost all the firms in the new industries were formed with foreign collaboration with TNCs which were unlikely to differ from ICI's unwillingness to incorporate the managing agency. The injunction to the enquiry committee to confine itself to the established industries is evidence of the perception that the system provided some advantages in these new ventures, situations where uncertainties might be expected to be greater. It is also of some interest that the committee, having chosen as its traditional industries, cotton textiles, jute textiles, cement, paper, and sugar, decided without explanation that managing agencies should be abolished in all except jute textiles and paper. Even given the existing, residual, British interests in jute, it is not overly speculative to conclude that the special attention given to this, one of the two oldest and most well-established industries, was due to their continuing influence on industrial policy. The Committee also fell in line with the go-slow policy, which had been pursued since 1956 in the area of industrial management reform. It recommended continuance of the policy of individual-application-wise rather than industry-wise consideration of appointment and re-appointment of managing agents.

However, the government in 1967 decided to terminate the managing agency system in five industries—cotton, sugar, cement, jute, and paper—effective from 1970. This momentous step was taken by a low-key administrative order, under Section 324 of the Companies Act. Notice was also given, in effect, that abolition in other established industries would follow soon. As a commentator in the *Economic and Political Weekly* noted, this rare fit of courageous decision-making was perhaps inspired by the need to improve the government's image after the ignominy it faced with the 1966 devaluation. However, in another comment a few years later, the journal reported that G.D. Birla had himself suggested that the penultimate rites for the system be performed, that is, that big business had itself conceded that the managing agency system was now proving dysfunctional.9 Subsequently, as part of the wide-ranging reforms in industrial finance, which included bank nationalization, the Government of India decreed the total abolition of the managing agency system from 1970.10 This happened after more than ten years of the passage of the 1956 Companies Act, nearly fifty years after the criticism voiced by the Indian Industrial Commission, and three-quarters of a century or more after the first stirrings of protest in Bombay in the 1890s.

Although, largely as a result of the outrage provoked in the Lok Sabha by the revelations of the Dalmia-Jain Commission's report, the managing agency system was finally abolished and there was never a return to the range of social engineering policies that Krishnamachari had introduced in the 1957 budget.11 The strategy then adopted seemed to be one that curtailed businessmen's proclivities in the financial sector (for instance, by nationalizing channels of delivery of funds for agriculture through takeovers of commercial banks), rather than the explicit measures that had cost Krishnamachari the finance minister's post in the earlier government.12

While detailed company-level analysis would be required to establish the case conclusively, from the extensive documentation over the forty-year period of financial irregularities made possible by the managing agency system, it would seem reasonable to conclude that by the late-1960s, the most backward forms of capital had been removed from the control of industrial enterprises. The tenaciousness of the struggle waged by it is only an indication of the complexity

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9 Not surprisingly, the Birla Group proved itself to be amongst those most adept in devising institutional mechanisms by which the financial advantages accruing through the managing agency system would continue (*Economic and Political Weekly* 1967, 1970a, and 1970b).

10 By the Companies (Amendment) Act, number 17 of 1969, passed in May that year, managing agencies were abolished with effect from 3 April 1970.

11 Shirokrov (1973) whose close reading of contemporary material is evidenced by his bibliography, notes that the 1956 Industrial Policy Resolution was forced through by 'middle ranking' sections of capitalists. However, further development of capitalist industrialization marked the end of 'bourgeois radicalism' (p. 59).

12 Interestingly, the report which is generally held to be the basis of the decision to nationalize the private commercial banks in 1969 mentions the advantages that nationalization would provide in curbing flows from the banking system to the unorganized rural money market (cf. Bettelheim's comments mentioned earlier). See Congress Parliamentary Party (1957: 65–6).
of the process of development of industrial capital in colonial societies. Equally glaring was the change of rankings of many of the big business groups, notorious from the days of Ashoka Mehta's pioneering pre-war pamphlets, and stable amongst the handful which were synonymous with the term 'big business' for the next thirty years.\textsuperscript{13} Their relative, if not absolute, decline in the industrial arena was an indication that without the instrumentality of the managing agency system with which to sustain their financial manipulations, they had succumbed to the logic of an industrial economy.

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\textsuperscript{13} Thus, the Dalmia-Jain Group and its offshoots were no longer within the group of the twenty largest industrial houses in terms of assets by the early 1980s. See Table II.2, p. 24 of Corporate Studies Group (1983), which is based on a reply to a Rajya Sabha question of 1981.