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RESEARCH ARTICLE

PRIVATISATION OF BANKS BOON OR BANE

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ABSTRACT

Recently, government of India has hinted that public sector banks can be privatized. This led to unrest among the bank employees and they went on protest strike. In this paper it is tried to show that how few (20) private banks has been nationalized in 1980's and same banks now government want to privatize. Motive of nationalization and motive behind privatization seems to be contradictory; same has been highlighted in this paper.

INTRODUCTION

A bank is a financial institution licensed to receive deposits and make loans. Banks may also provide financial services such as wealth management, currency exchange, and safe deposit boxes. There are several different kinds of banks including retail banks, commercial or corporate banks, and investment banks. In most countries, banks are regulated by the government or central bank of the country. In this paper we have considered Schedule commercial banks in India as per RBI's Schedule. **Brief History of Banks in India:** Modern banking in India originated in the mid of 18th century. Among the first bank was the Bank of Hindustan, which was established in 1770 and liquidated in 1829–32[i]. The largest and the oldest bank which is still in existence is the State Bank of India (SBI). It originated and started working as the Bank of Calcutta in mid-June 1806. In 1809, it was re-named as the Bank of Bengal. This was one of the three banks founded by a presidency government, the other two were the Bank of Bombay in 1840 and the Bank of Madras in 1843. The three banks were merged in 1921 to form the Imperial Bank of India, which upon India's independence, became the State Bank of India in 1955. For many years, the presidency banks had acted as quasi-central banks, as did their successors, until the Reserve Bank of India was established in 1935, under the Reserve Bank of India Act, 1934[ii]. The Reserve Bank of India, India's central banking authority, was established in 1st April 1935, but was nationalized on 1st January 1949 under the terms of the Reserve Bank of India (Transfer to Public Ownership) Act, 1948 (RBI, 2005b)[iii].

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In 1949, the Banking Regulation Act was enacted, which empowered the Reserve Bank of India (RBI) to regulate, control, and inspect the banks in India. The Banking Regulation Act also provided that no new bank or branch of an existing bank could be opened without a license from the RBI, and no two banks could have common directors.

Nationalization of 20 Banks: On July 19, 1969, Indira Gandhi who was both Prime Minister and Finance Minister at that time decided to nationalize 14 largest private banks of the country. With Imperial Bank already nationalized and renamed as State Bank of India in 1955, this decision pushed 80 percent of banking assets under the control of the state.

Political And Economic Background of Nationalization of Banks: The reason for nationalizing banks was to sync the banking sector with the goals of socialism adopted by the Indian government after independence. RBI's history points that the idea to nationalize banks and insurance companies germinated as early as 1948, as per All India Congress Committee report. The insurance sector was nationalized in 1956 with the formation of Life Insurance Corporation of India but banks had to wait till 1969, barring the case of SBI which was nationalized in 1955. As RBI's history points out, we had war with China in 1962, followed by Prime Minister Jawaharlal Nehru's death in 1964. This led to the appointment of Lal Bahadur Shastri as Prime Minister who soon saw war with Pakistan in 1965. Then Shastri died suddenly in 1966, leading to the appointment of Indira Gandhi. Apart from these political events and wars, the 1960s also had two droughts, leading to negative GDP growth rates and double-digit inflation. Foreign exchange too declined in 1964-65. These economic conditions led the government to devalue the Rupee from 4.76 per U.S. dollar to Rs 7.50/$ in 1966.

Apart from devaluation, export duties were levied on a dozen commodities. Prime Minister Indira Gandhi needed a serious instrument to reposition herself as a radical reformer and she used nationalization of banks to signal this change.

Neglect of bank credit to marginal sections of society is another reason: There was a long-standing criticism that Indian banks were not willing to provide credit to agriculture. Also, since the private banks were run by big industrialists, they gave loans to themselves. The directors of the top banks also held directorships in several other industries leading to conflict of interest. The share of agriculture in credit was 2 percent in 1951 and remained unchanged in 1967. Whereas, the share of industry has increased from 34 percent in 1951 to 64.3 percent in 1967. We see a similar picture in bank branches as well. Banks had increased branches from around 4,000 in the 1950s to around 7,000 by 1967 but the share of rural and semi-urban branches remained similar at 61 percent. The share of urban branches increased from 36 percent in 1952 to 39 percent in 1967.

The Banking Companies (Acquisition and Transfer of Undertakings) Act, 1969 laid down the conditions for nationalization. The objective of the Act was "to serve better the needs of development of the economy in conformity with national policy and objectives". Government has nationalized the 14 largest commercial banks on 19 July 1969. These banks held over 80 per cent bank deposits in the country. The banks that were nationalized included Allahabad Bank, Bank of Baroda, Bank of India, Bank of Maharashtra, Central Bank of India, Canara Bank, Dena Bank, Indian Bank, Indian Overseas Bank, Punjab National Bank, Syndicate Bank, UCO Bank, Union Bank and United Bank of India. Thereafter, in 1980, six more banks that were nationalized included Punjab and Sind Bank, Vijaya Bank, Oriental Bank of India, Corporate Bank, Andhra Bank and New Bank of India. The stated reason for the nationalization was to give the government more control of credit delivery. With the second round of nationalizations, the Government of India controlled around 91% of the banking business of India.

Rise of Private Modern Banks: In the early 1990s, the then government embarked on a policy of liberalization, licensing a small number of private banks. These came to be known as *New Generation tech-savvy banks*, and included Global Trust Bank (the first of such new generation banks to be set up), which later amalgamated with Oriental Bank of Commerce, IndusInd Bank, UTI Bank (since renamed Axis Bank), ICICI Bank and HDFC Bank[iv].

Strengthening of SBI:- SBI was merged with its associate bank of State Bank of Saurashtra in 2008 and State Bank of Indore in 2009. The merger, of the 5 remaining associate banks, (viz. State Bank of Bikaner and Jaipur, State Bank of Hyderabad, State Bank of Mysore, State Bank of Patiala, State Bank of Travancore and the Bharatiya Mahila Bank) with the SBI, went into effect from 1 April 2017[v].

Thought for Privatization of Banks Arise: Bad loans: Even as the government's control have come down significantly since the period of liberalization, the problem of bad loans has put pressure on the banks. Both government and the banking regulator RBI has come out with a host of measures to tackle the problem of Non Performing Assets (NPAs).

In budget 2019, Finance Minister Nirmala Sitharaman has announced proposal of infusion of Rs 70,000 crore into the Public Sector Banks (PSBs) to solve their problem of liquidity. According to RTI activist, Vivek Velankar (30 November 2020) [vi], who studied the annual reports of 10 banks for the past eight years and the information he gathered was shocking. Over the past eight years, these 12 nationalized banks together have written off bad loans worth Rs 6.32 lakh crore and recovered just Rs 1.08 lakh crore, or 17%. Except SBI and IOB, all other PSBs refused to disclose names of these big defaulters, claiming it as confidential information and that disclosing it would be breach of privacy. The total loan write-off by private and state-owned banks in the last 10 years since 2009 has touched a whopping Rs 4,80,093 crore as on March 31, 2018 – 83.4 per cent of this amount, or Rs 400,584 crore, was from public sector banks, according to figures compiled by rating agency ICRA for The Indian Express. Of the write-off for 2017-18, Rs 1,20,165 crore loans were written off by public sector banks[vii]. Banks normally resort to write-offs in the case of loans which are in the doubtful recovery category. "It is technical in nature. It's a book adjustment. When a bad loan is written off, it goes out of the books of the bank. The bank will also get tax benefits. However, the bank will continue the recovery measures even after the loan is written off," said Pradeep Ramnath, former chairman and MD of Corporation Bank. SBI alone wrote off Rs 1,23,137 crore over the last 10 years, while Bank of India wrote off Rs 28,068 crore followed by Canara Bank with Rs 25,505 crore and PNB with Rs 25,811 crore, according to ICRA figures.

Private banks wrote off Rs 23,928 crore in the year ended March 2018 against Rs 13,119 crore the previous year — Axis Bank wrote off Rs 11,688 crore and ICICI Bank Rs 9,110 crore. The total write-offs by private banks in the last 10 years amounted to Rs 79,490 crore. Public sector banks suffered a loss of over Rs 87,000 crore in the fiscal year ended March 2018 owing to higher provisioning towards NPAs and losses in the bond portfolio.

BAD LOAN WRITE-OFFS IN LAST 10 YEARS

(Rs /crore)

YEAR	PSU	PRIVATE	TOTAL
2009	1,594	570	2,165
2010	7,828	7,240	15,068
2011	17,729	2,570	20,299
2012	14,614	3,633	18,248
2013	26,524	5,025	31,549
2014	28,920	6,504	35,424
2015	46,179	6,767	52,947
2016	61,121	10,133	71,253
2017	75,929	13,119	89,048
2018	1,20,165	23,928	1,44,093
TOTAL	400,584	79,490	480,093

Source: ICRA

TOPPERS IN LOAN WRITE-OFFS

(Rs/crore)

Bank	Write-off in 2017-18	Total Write-off in 10 years
SBI	40,281	1,23,137
Bank of India	9,093	28,068
Canara	8,310	25,505
PNB	7,407	25,811
ICICI	9,110	24,493
AXIS	11,688	23,077
IOB	10,307	23,117
IDBI	6,632	10,546
ALLAHABAD	3,648	16,313
BoB	5,200	16,920

Source: ICRA

Every Scheduled commercial banks have to lend 40 percentage of their total lending to priority sectors like agriculture, small scale industries, export sector, marginal SHGs etc. From above chart we can see that Public sector banks had provided almost twice (Rs 23 lakh crore) the amount of private sector (Rs 14 lakh crore) in 2020-21. Master Directions- Reserve Bank of India (Priority Sector Lending – Targets and Classification) Directions, 2020. The categories under priority sector are as follows: Agriculture, Micro, Small and Medium Enterprises, Export Credit, Education, Housing, Social Infrastructure, Renewable Energy, and Others[viii].

Rural Bank Branches: Branch expansion of scheduled commercial banks has increased from 4061 in 1952 to 32,419 in 1980 and 1,42,642 in 2018. In this share of rural branches has increased from 13 % in 1952 to 36 % in 2018. It shows increasing credit reach to rural India that may reduce after privatization of banks. From 1969, when the banks were nationalized, India has progressed from 8,187 banks to more than 1,60,000 banks in the present times. In 1969, the rural reach of the banks stood at a mere 1,443 to more than 52,000 banks as of September 2020. Interestingly, the spread of Public Sector Banks is far more than the reach of private-sector banks in rural areas.

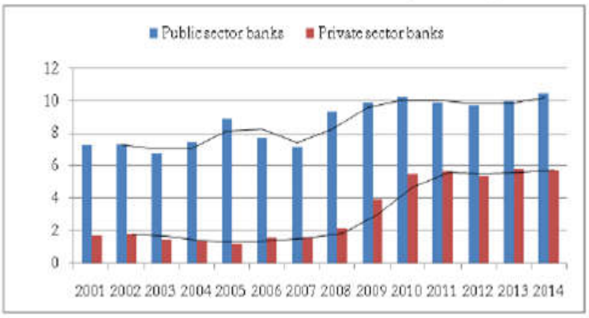
Branch expansion of scheduled commercial banks: 1952-2018

	Total	Rural	Share of rural branches (%)	Semi-Urban	Share of Semi-Urban branches (%)	Urban & Metropolitan	Share of Urban & Metropolitan branches (%)
1952	4,061	540	13	1942	48	1451	36
1960	5,026	831	17	2512	50	1633	32
1969	8,262	1833	22	3342	40	3087	37
1980	32,419	15105	47	8122	25	9192	28
1990	59,752	34791	58	11324	19	13637	23
2000	65,412	32734	50	14407	22	18271	28
2010	85,170	31845	37	21313	25	32012	38
2018	1,42,642	50748	36	39695	28	52199	37

Source: Handbook of Statistics on the Indian Economy & Volume IV (2006-08) of the Special Edition of the Report on Currency and Finance, RBI

After privatization providing credit to rural area and marginal sectors will be difficult. From Chart 4.11, we can see that private sector banks hardly gave 2% of Adjusted Net Bank Credit (ANBC) loan to weaker section of the country in 2001 to 2008, whereas public sector banks lend more than 7% of ANBC loan to weaker section. Same has increased almost 5 % loan by private banks and almost 10 % loan by public sector banks to weaker sections in 2009 to 2014. It means privatization of banks can further reduce loan to weaker sections in future.

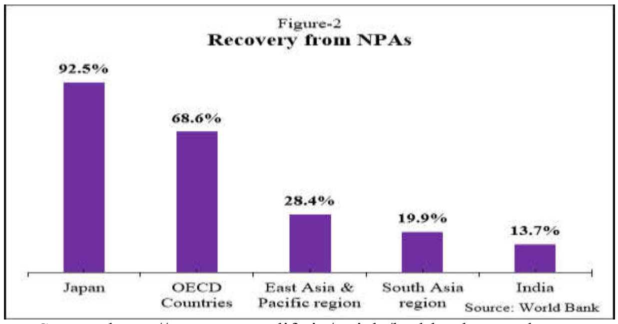
Chart 4.11: Bank loans to weaker sections as percentage of ANBC



Source: RBI, Report on Trend and Progress of Banking in India and as reported by banks.

Bad Debt: The finance minister (FM) has stated that an Asset Reconstruction Company (ARC) and an Asset Management Company (AMC) would be set up to consolidate and take over the existing stressed debt of the banks. The ARC/AMC taking over the existing stressed debt of public sector banks (PSBs) has been described as Bad Bank (BB). In India there is a significant impact of bank NPAs (non-performing assets) on the country's GDP since the country's financial system is predominantly bank-based. This means that the banks must have manageable NPA levels which, in the worst case, should be significantly less than 5% as is seen worldwide and even for well-run private sector banks in India. However, NPAs of Indian banks, particularly the PSBs remain unmanageably high (figure-1). NPAs of PSBs, which had shown a sudden spurt of 93.9% in FY15-16, have stayed high since then. This spurt was due to the Asset Quality Review (AQR) introduced by the Reserve Bank of India (RBI) governor in 2015. Recoveries of banks (predominantly PSBs) are among the lowest in the world (figure-2).

In comparison, (Stressed Asset Stabilization Fund) SASF's recovery of 38.62% is phenomenal, though far from desirable.



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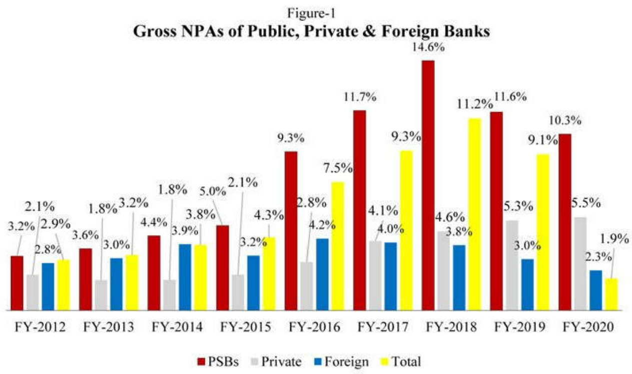

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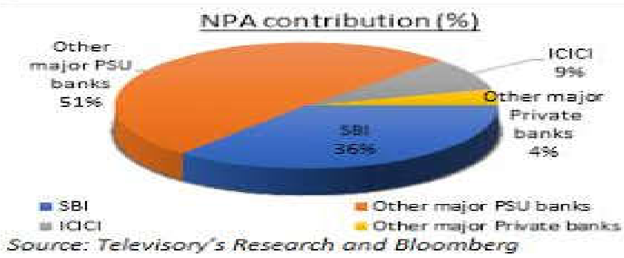
Table1: Bad Loans of PSBs

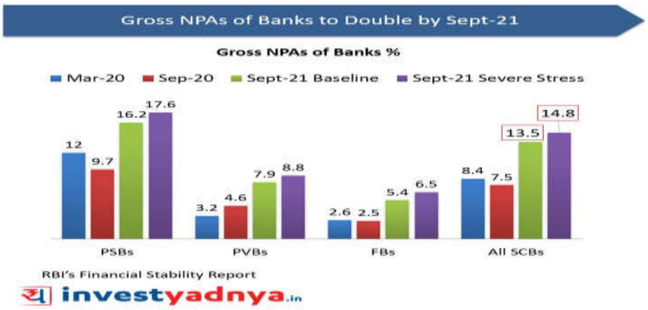
Bank	Gross NPAs	Bank	Gross NPAs
IDBI Bank Limited	**27.5%**	Corporation Bank	13.8%
Central Bank of India	18.9%	United Bank of India	13.4%
Allahabad Bank	17.1%	Bank of Maharashtra	12.8%
UCO Bank	16.8%	Oriental Bank of Commerce	12.7%
Andhra Bank	16.1%	Syndicate Bank	12.0%
Bank of India	14.8%	Bank of Baroda	9.4%
Indian Overseas Bank	14.8%	Canara Bank	8.0%
Punjab National Bank	14.2%	Indian Bank	6.9%
Punjab and Sind Bank	14.2%	State Bank of India	6.2%
Union Bank of India	14.1%		

Source: https://www.moneylife.in/article/bad-bank-remedy-or-malady/62878.html retrieved on 26-03-2022 at 8.43 pm.

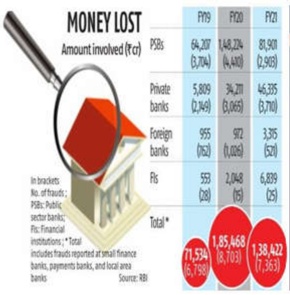


There is a fairly high correlation coefficient of 0.77 between the government ownership of banks and NPA levels. The country, therefore, cannot turn a blind eye to the government's ultimate responsibility of PSB mismanagement and huge NPAs. This was hinted at by Dr Raghuram Rajan with the following words in his book "I Do What I do". PSB mismanagement was also highlighted in Dr PJ Nayak Committee Report in May 2014 which had lamented that the government as PSB shareholder had suffered deeply negative returns over decades (due to mis-governance and incompetent boards) and had, therefore, recommended government's exit from the bank management.

The government seems to have recognized the malaise and has announced privatization of two PSBs now, apart from setting up the Bad Bank (BB).

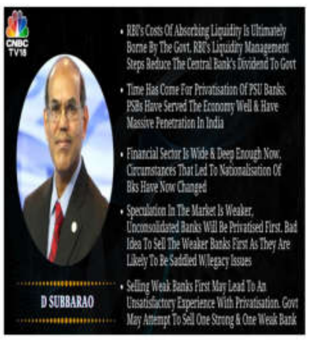


Bank Fraud: Total Bank frauds in public sector banks and private sector are respectively 2903 and 3710 in 2021, however monetary amount is quite double in public sector bank which can be seen from following table. Following chart shows that after 2016-17 banking fraud has increased rapidly from 5071 to 83,638 in 2020-21.



Dr. Raghuram Rajan seems to be against privatization of banks and Dr. D. Subarao is in favour of privatization.


'Move to sell govt banks a colossal mistake'



Privatization of Banks: Finance minister Nirmala Sitharaman had announced privatization of two public sector banks as part of the disinvestment programme for this fiscal. Niti Aayog had reportedly shortlisted Central Bank of India and Indian Overseas Bank for the purpose. However, a final decision on the candidates is yet to be taken[ix]. The government has not listed the Banking Laws Amendment Bill 2021 in the ongoing session of Parliament. The bill seeks to make changes to the Banking Companies Acquisition and Transfer of Undertakings Act, 1970 and 1980, and incidental amendments to the Banking Regulation Act, 1949. One of the key proposals of the bill is that the government will retain 26% stake in the banks identified to be privatized. In the 2022-23 budgets, the government has not budgeted any receipts from disinvestment of government stake in public sector banks and financial institutions, and lowered the disinvestment target to Rs 65,000 crore.

Banking Laws (Amendment Bill 2021): The Bill aims to amend banking companies acquisition and transfer laws of 1970 and 1980 and the Banking Regulation Act, 1949 to achieve privatisation of two PSBs to meet disinvestment targets as stated by the finance minister in the Union Budget 2021-22. These laws had led to the nationalization of banks, so relevant provisions of these laws have to be changed to pave the way for the privatization. This move will bring down the minimum government holding in the PSBs from 51% to 26%.

Recommendations of Different Committees

- Many committees had proposed bringing down the government stake in public sector banks below 51%:
- The Narasimham Committee proposed 33%.
- The P J Nayak Committee suggested below 50%.
- An RBI Working Group recently suggested the entry of business houses into the banking sector.

RBI, NITI Aayog, the Finance Ministry and the Department of Economics actively discuss the first phase of privatization in the Rs 1.75 lakh crores disinvestment plan. NITI Aayog has circled four banks for its disinvestment plan, namely, Bank of Maharashtra (BoM), Bank of India (BoI), Indian Overseas Bank (IOB) and the Central Bank of India (CBI)[x]. Assuming that the government would divest its entire stake in the two banks under discussion, it stands to gain at least ₹57,000 crore. (Indian Overseas Bank's market cap is over ₹40,000 crore and the government holds 96.38 % stake. Central Bank of India's market cap is nearly ₹20,000 crore and the government holds 93.08% stake.) For the government, this disinvestment along with partial disinvestment in LIC through its IPO could mean accrual of over ₹1,10,000 crore[xi].

Against Privatization of Banks: Non-Performing Assets (NPAs), as seen from the Economic Survey 2020-21, are not exclusively generated in PSBs. The NPAs of private banks up to March 2020 amounted to ₹ 2,05,848 crore against ₹6,87,317 crore in PSBs.

- Moreover, an ordinary Indian citizen has always had trust in the government. People find it safe to keep their money in PSBs because they know they have the government to run to even if the bank fails. On the other hand, if a private bank declares itself insolvent, there is nothing much that the customer could do except repents.
- The state-run banks are also responsible for managing more than 97 per cent of Jan Dhan accounts under the government.
- The outstanding agriculture credit was Rs 4,50,207 crore (86.6 per cent in total credit to agriculture) as of March 2020, against the private banks' Rs 72,893 crore (13.94 per cent).
- The major problems with the public sector banks (PSBs) are governance, political interference and to an extent expertise which may not have kept pace in the area of credit evaluation and these can and need to be addressed, Madan Sabnavis, Chief Economist, CARE Ratings told Financial Express Online.
- The All India Bank Officers' Confederation (AIBOC) said privatization of public sector banks (PSB) would

result in job losses, branch closures and financial exclusion. “PSB mergers have brought down the number of public sector banks from 27 to 12, setting in motion the process of employee retrenchment and bank branch closures; total employee strength of PSBs has fallen from 8.57 lakh in March 2017 to around 7.7 lakh in March 2021,” the apex organization of bank officers in the country said in a presentation, adding that the total number of PSB branches declined by 3,321 between March 2017 and September 2021[xii].

- The SC/ST/OBC sections would be deprived because unlike the public sector, the private sector does not follow reservation policies for the weaker sections.
- A significant number of private banks and financial institutions have failed in recent times, like the Yes Bank, Lakshmi Vilas Bank, IL & FS and DHFL; in contrast, there is not even a single instance of bank failure in the case of PSBs, Rs 86,986 crore had been recovered from written-off loan accounts through various channels between2016-17 and 2020-21.

CONCLUSION

After seeing various boon and bane of privatization, it can be concluded that strong Public Sector Banks (PSBs) should not be privatized; in fact they should be given autonomy status like Navratna status given to strong PSUs. Weaker PSBs should be identified and its causes can be addressed, if needed they can be merged with strong PSBs. Even if government want to reduce their fiscal deficit in future by privatizing these PSBs then government stake holding should not reduce below 50 %. Marginal sections of society, rural credit need, subsidized loan can be meeting through PSBs and it was main objective of nationalization of private banks in 1980s. We need to improve bank administration and management, minimum interference from government agencies. Channelizing the bank credit to targeted group can be possible through PSBs and this also can help better control on monetary policy by RBI. The Problems of bank fraud, bad debt, huge NPAs are common in private sector banks also. We need to provide correct medicines for these banking deceases and mere privatization is not the right solution. Private Banks has only profit motive however PSBs has main motive of social welfare and growth of neglected sections of the economy.

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