India banking reforms evoke protests

by Ramtanu Maitra

On May 9, the Indian Parliament adopted a bill, introduced by Minister of State for Finance V. Chandrashekhar Murthy, to allow private individuals and companies to hold 49% of the shares of nationalized commercial and development banks. The opposition, aware of the support behind the bill, walked out of the House in protest.

The Banking Amendment bill is the first serious effort by the government to loosen its grip over the commercial and development banks that were nationalized in 1969. When the commercial banks were nationalized, many broad objectives were laid down by the government. One was to provide greater lending to encourage the productive endeavor of the economically weaker section of society, and thus to ensure equitable distribution of credit. Prior to the vote, Murthy said that the central government would continue to hold control over the banks, and assured the House that the banks would continue to provide loans to the rural sector and to lend to priority sectors. He pointed out that partial privatization was necessary to provide for capital adequacy in the banking instutitions.

The statement of "objects and reasons" of the bill said that during 1985-93, the central government had provided 40 billion rupees to the paid-up capital of the banks. And 57 billion rupees had been provided during the current budget year. It added that the government now felt that it could no longer continue to make those contributions and had decided that the banks should be allowed to enter the capital market to raise equity to meet the shortfalls and its growing requirements.

The bill also said that out of 15 directors on the board, nine would be nominated by the central government and the other six would be non-official nominees. There will be two directors from among the employees of the bank. The bill also prohibits private shareholders from acquiring total voting rights exceeding 1% in any bank.

The opposition, led by Janata Dal leader George Fernandes, accused the ruling party members of becoming spokesmen of private vested interest groups and of showing enthusiasm for privatizing national banks. He reminded ruling party members of the commitment made by the late Prime Minister Shrimati Indira Gandhi, when banks were nationalized, and said that those in the Congress Party who had opposed the nationalization then are now emerging as the ruling class.

Behind the opposition party bluster lies the fear that the government, by allowing 49% of the shares to be transferred to private owners, is setting the stage for an eventual denationalization of the banks. The opposition's fears come from a number of factors. First, the World Bank study of India's financial sector reforms, made available in 1991 soon after the Rao government came to power, pointed out that commercial lending had become politicized because of government involvement. This politicization, together with the pressure to meet quantity targets, has led to a serious problem of bad debt.

Identifying the commercial banks as one of the most deteriorated institutions in India, the World Bank said that they are barely profitable and if their bad debts were fully provided against, their low capital base would be completely eroded.

The review committee

Soon after, the Rao government set up a review committee to prepare a report on the financial sector reforms. Led by former governor of the Reserve Bank of India M. Narasimham, the panel report stayed away from recommending any privatization of nationalized banks, but suggested that the appointment of chief executives of the banks and the boards should be depoliticized. The panel also suggested computerization of the banking sector at an enhanced speed, a recommendation which is hotly contested by the trade unions associated with the bank employees. The Narasimham committee also suggested that the government should remove disincentives for the more dynamic among the private banks, to help them to grow.

However, the committee said explicitly that the aim was to find ways to make the financial sector lean, mean, competitive, and healthy, without denationalization. The report shifted the onus from "ownership" to efficiency and competitiveness, and did not demand that shock therapy be applied to the financial sector.

While the government has little quarrel with the Narasimham committee report, it is evident that the Rao government's decision to implement only a part of the report is based solely on political exigencies. As the same time, the Finance Ministry has continued with its plan to abide by the report with the ostensible objective of making the financial sector efficient and independent of budgetary sops. A spate of articles have appeared in recent days depicting the poor state of affairs in the commercial banks and the news that the public sector banks suffered a loss of 33.7 billion rupees in 1992-93. In comparison, the Indian private sector banks, much smaller compared to some of the public sector banks, performed well in 1992-93, earning a profit of 600 million rupees.

However, the problem with public sector commercial banks cannot be overcome simply by exposing them to competition, some point out. Banks cannot solve problems inhibiting recovery unless the legal environment is changed. The problems of rural credit do not merely involve regional rural banks, but also relate to the weaknesses of the cooperative structure.