50 Years of Banks Nationalisation

Why in news?

July 19, 2019 marks 50 years of nationalisation of 14 commercial banks in India by the Indira Gandhi government.

What is bank nationalisation all about?

- State Bank of India was the only public sector undertaking that was nationalised (in 1955) before 1969.
- The SBI nationalisation had happened in the backdrop of private banks going bankrupt at an alarming rate.
- In 1969, Indira Gandhi government carried out bank nationalisation through the Banking Companies (Acquisition and Transfer of Undertakings) Ordinance, 1969.
- Fourteen big private banks were nationalised, to be taken control of by the government.
- These lenders held over 80% bank deposits in the country.
- The banks that were nationalised were:

    1. Allahabad Bank
    2. Bank of Baroda
    3. Bank of India
    4. Bank of Maharashtra
    5. Central Bank of India
    6. Canara Bank
    7. Dena Bank
    8. Indian Bank
    9. Indian Overseas Bank
    10. Punjab National Bank
    11. Syndicate Bank
    12. UCO Bank
    13. Union Bank
    14. United Bank of India

- In 1980, the government took control of another 6 banks.
- These included Punjab and Sind Bank, Vijaya Bank, Oriental Bank of India, Corporate Bank, Andhra Bank and New Bank of India.

What was the rationale?

- There were issues related to the reach and flow of credit to important sectors, and these were dealt with through various ad-hoc measures in 1960s.
- E.g., the fragmentation was addressed through consolidation of banks
- The number of banks was brought down from 566 in 1951 to 91 in 1967.
- Before nationalisation in 1969, the government tried addressing some of the issues through "social control".
- The idea was to attain a wider spread of credit and increase the flow to priority sectors.
- However, overall, banks were failing largely due to speculative financial activities.
- After 1967, when Ms. Indira Gandhi became the PM, banks were not giving credit to agriculture and not enough credit to industry.
- The banks were more interested in extending credit for trade.
- The collapse of banks was causing distress among people.
- People were losing their hard-earned money in the absence of a strong government support and legislative protection to their money.
- Given this, nationalisation of banks was a more populist and rational choice for the government.

- Given these, the key objectives of nationalisation of banks were to -
    i. address the rising economic difficulties in the 1960s
    ii. remove control of the few on banking system
    iii. provide adequate credit for agriculture, small industry and exports
    iv. professionalize bank management
    v. encourage a new class of entrepreneurs

What was the implication?

- The nationalization is one of the most significant economic events after India's independence.
- Bank nationalisation resulted in a significant increase in bank deposits and financial savings.
- In this backdrop, the rising fiscal deficit made the banking sector a captive source of financing.
- With continued political intervention, the profitability of the banks suffered.
- Over the years, this affected bank operations.
- In all, the government succeeded partially in meeting its goal of implementing its development agenda through the banking system.
- However, many in India lacked access to formal finance and a large part of the population remained outside the banking net.

What are the current challenges?

- Today, most public sector banks (PSBs) are not in the desired position.
- The government has pumped in over Rs 2.5 trillion in the last few years (including Rs 70,000 crore in 2019) and it still may not be enough.
- PSBs continue to struggle with a higher level of non-performing assets.
- **Recapitalisation** - The government does not have the fiscal space to continuously pump capital into PSBs. Click here to know more on recapitalisation.
- The idea of using recapitalisation bonds too has its limits as it is increasing the government's liability.
- **Technology** - The role of technology in banking and finance is rising rapidly.
- PSBs, with their weak balance sheets, are not in the best position to adapt and compete on this front.
- Naturally, the business will increasingly shift towards private sector banks.
- **Reforms** - It would be hard to implement the required reforms in PSBs in the present set-up.
- PSBs, which account for 66% of outstanding credit and 65.7% of deposits, need functional and operational independence.
- With the government being the majority shareholder, this will be difficult to attain.

What is the way forward?

- The 50th anniversary of banks nationalisation is a good opportunity to objectively review the performance of PSBs and take corrective measures.

- The government can perhaps revisit the recommendation of the Narasimham Committee on banking sector reforms in this context.
- Bringing down government equity to 33% will give banks the much-needed functional autonomy.
- It will also enable them to raise capital and compete in the market.

Source: Business Standard