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Business

What is the way forward for the ailing banking sector in India?

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- The well-developed corporate bond market and variant fixed income structure are indispensable for the sustainable and 'inclusive' growth.
- The revival of growth in agriculture and SMEs is sine qua non to tackle the slowdown and generate employment.

GOURISHANKAR HIREMATH

India's banking sector seems to be passing through a difficult stage. The non-performing assets (NPAs) as a percentage of gross advances stood 11. 6 percent, and this ratio for public sector banks (PSBs) is 14.6 percent. The PSBs account for 86 percent of the NPAs. The growth rate of aggregate deposits have plunged to 6 percent, and credit growth has slackened to 10 percent in the last 15 years.

With the IMF cutting India's growth projection, the slowdown aggravates the problem of bad loans in the debt market. The public ownership of banks and 'populist' loans, especially to the agriculture sector, were often cited as causes of the current impasse by the neoclassical economists and commentators, experience of reforms speaks otherwise. In addition, the trouble is brewing even in the private sector banks.

Missing from the mainstream debate on the impending crisis in India's banking sector has been the political economy of the neoliberal regime and policy contradictions. There is a need to trace the genesis of the current stalemate in those contradictions to offer effective policy inputs.

The genesis of the crisis

The post-independent development planning adopted state capitalist system. The state became the biggest investor in the industrial sector. While Development Financial Institutions (DFIs) were created to cater to the needs of industrialisation, the commercial banks met the needs of working capital. In 1969, the government nationalised the banks with the objective of welfare goals of the state.

However, in reality, the dominant proprietary classes such as rich farmers and industrial capitalists, as Pranab Bardhan pointed out, had a dismal record of non-repayments of loans despite availing subsidised credit. As a result, resources of the PSBs began draining; profitability was jeopardised and politicisation of its management eroded operational autonomy. However, the nationalisation achieved many of the welfare goals. It bolstered a notable growth in the employment generating sectors such as agriculture and allied activities, and small and medium enterprises (SMEs).

The branch expansion led to the financial deepening, and a notable section of the population was given access to banking services, which brought socio-economic changes. The deposits with PSBs registered an average growth rate of 18 percent between 1969 and 1991 and so the overall saving rate in the economy.

In 1991, India embraced globalisation and introduced market-oriented reforms. The policy gradually freed PSBs from mandatory investment in government securities; and emphasis was given on competitiveness and profitability of PSBs. However, the primary character of the PSBs required for a new environment did not change except stressing truncation of social goals. Ironically, PSBs continue to invest in Treasury instruments, and investment in non-government securities gradually decreased from negligible amount during the reforms period.

The lack of expertise, poor decision making, and risk aversion of PSBs explain such reluctance to invest in competitive instruments. In a liberalised economy, paradoxically, the PSBs were institutionally ordained by the state to provide credit to industries; especially to the infrastructure sector. This added woes to the already ailing banking sector. The growth

The priority sector lending often receives scathing criticism for bad loans, but the NPAs in non-priority sector rose to a staggering 80 percent of the total NPAs. The top 100 large corporate borrowers now account for 18.6 percent of NPAs. The total write-off of bad loans during the last ten years was Rs 7 lakh crore. The NPAs of 12 corporate NPAs cost exchequer twice as much as farm loan waivers, claims a report.

According to CNN-News18, SBI alone wrote off Rs 76,600 crore and private banks also following suit. So, public resources have become a bulwark to the private capital during the reforms era.

Dormant corporate bond market

The corporate bond market is supposed to be a major source in a market-based framework. Without foresight, DFIs were converted as commercial banks much before the bond market was developed. The feeble measures to develop such a market left it in dormancy. The efforts to develop a competitive fixed income segment largely got stacked in working papers and reports. The share of bonds in India's total corporate debt is a mere 8 percent.

The corporate debt has grown to 56 percent of GDP in 2019, but corporate bonds remained stagnant at 4 percent of GDP. In India, even large firms are reluctant to raise finance from the bond market. While the efficiency of private capital is boasted as sacrosanct, but hardly it could raise finance from competitive markets in which the disclosures and asset quality assessment are stringent. The corporate sector in India finds bank finance as a more comfortable option due to its disingenuousness related to projects. In a market-oriented economy, mandating of Securities and Exchange Board of India (Sebi) to large corporates to raise 25 percent borrowings through bonds is an awkward predicament.

SMEs face credit crunch

Due to the mounting NPAs and continued dominance of big businesses and their political clout, SMEs are unable to avail credit from the PSBs. The maturity mismatch of asset-liability of banks and companies exposes the former to caprices of latter’s entrepreneurial risk. To make the matter worse, the proposal to finance the shadow banking by the PSBs would expose the balance sheets of the latter to contagion effects. The objective of financial liberalisation in India was to liberalise the finance from the control of the State, but paradoxically it turned as the seizure of public resources for the rapacity of private capital.

The glaring crisis in banking sector indicates the squalid collapse of financial liberalisation in India. The creditors are not meant to share the entrepreneurial risk, but PSBs have been forced to do so since the liberalisation of economy. The without democratic participation. The financial sector reforms in India seldom prioritised the protection of depositors and investors in the event of market failure. The reforms in India socialised the cost while protecting private profits. As Noam Chomsky rightly points out, "a basic principle of modern state capitalism is that costs and risks are socialised to the extent possible, while profit is privatised."

The way forward

In order to end this impasse, long term solutions, as opposed to knee-jerk reactions, are essential. The well-developed corporate bond market and variant fixed income structure are indispensable for the sustainable and ‘inclusive’ growth. The measures to strengthen the corporate bonds market proposed in the recent budget by the Finance Minister are welcome steps. The reforms in market microstructure, including transparency, low cost, and liquid fixed income market, and building of the bond market infrastructure are essential policy measures for the vibrant bond market. The measures to migrate the large firms to competitive credit markets are inevitable.

The privatisation of PSBs apparently is an easy solution but not desirable. Instead, reforms in the corporate governance of PSBs including independent directors and audit committees, will ensure operational autonomy, independent supervision, and higher accountability of PSBs. Such measures will improve efficiency and profitability. The relatively higher recovery rate of PSBs through Insolvency and Bankruptcy Code (IBC) than previous mechanisms call for freedom to banks to use IBC; there is also a need to strengthen the act further.

Privatisation is not the answer

Privatisation is not a panacea for the ills of PSBs, as is evident from the experience of three decades of reforms. Moreover, privatisation derails financial deepening process and the welfare schemes, especially that are facilitated through Jan Dhan bank accounts. The revival of the growth in agriculture and SMEs is sine qua non to tackle the slowdown and generate employment; and it cannot be achieved without cheaper and easier access to credit. The Mudra scheme is an attempt in the right direction. However, without autonomy in decision making and fundamental corporate governance standards, the scheme with good intention and welfare goals may meet the same fate of subsidised credit during the planning era. Although seems unusual, there is a need to revive the rural cooperative societies according to the present priorities. These societies with extensive network were neglected for a long time and can be roped in to meet the needs of the rural population so that the burden on PSBs can be lessened.

The PSBs can meet the needs of these sectors better

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NETWORK 18 SITES: Moneycontrol In.com TopperLearning Overdrive News18 Cricketnext Forbes India Firstpost competitive market, and public resources are channelised to meet social goals.

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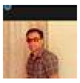

Desmond Mascarenhas

Privatization of banks is of paramount importance for these banks to clear the mess. Once these banks are privatized they will start generating profits just like HDFC Bank, ICICI Bank etc. As of today there is no mutual fund managers who wants to invest in PSU Bank stocks.

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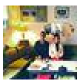

Tuli Bakshi

We have had a major decline in private investment which has to be revived. Agriculture is not being doing well. Employment has been a problem. Exports have been doing very badly. Banking situation is terrible. So if the government wanted to address real problems with real solutions following real data and statistics, they would have done that already instead of all these knee jerk things. They