# Privatisation of Banks

**For Prelims:** Baking in India and related laws, Functions of RBI, Asset Reconstruction Company (Bad Bank)

**For Mains:** Privatisation of banks, its significance and related issues, Impact of Nationalisation of banks in pre liberalisation Era

## Why in News?

The government is in the **process of taking 'advanced action' to expedite the privatisation of public sector banks.**

- The government is **geared up to take further steps** to rein in **inflation** as well as maintain economic stability and growth.

## What is Privatisation?

- The **transfer of ownership, property or business from the government to the private sector** is termed privatisation. The government ceases to be the owner of the entity or business.
- Privatisation is **considered to bring more efficiency and objectivity** to the company, something that a government company is not concerned about.
  - India went for privatisation in the historic reforms budget of 1991, also known as **'New Economic Policy or LPG policy'.**

## What is the Background?

- The government decided to **nationalise the 14 largest private banks in 1969**. The idea was to align the banking sector with the socialistic approach of the then government.
  - **State Bank of India (SBI)** had been nationalised in 1955 itself, and the insurance sector in 1956.
- Various governments in the last 20 years were for and against privatisation of **Public Sector Undertaking (PSU)** banks. In 2015, the government had suggested privatisation but the then **Reserve Bank of India (RBI)** Governor did not favour the idea.
- The current steps of privatisation, along with setting up an **Asset Reconstruction Company (Bad Bank)** entirely owned by banks, underline an approach of finding market-led solutions to challenges in the financial sector.
- The Centre had **announced the privatisation of two public sector banks in the** Budget **for 2021-22** but is yet to amend the relevant banking laws to enable the sale of its majority stake in them.

## What are the Reasons for Privatisation?

- **Degrading Financial Position of Public Sector Banks:**
    - Years of capital injections and governance reforms have not been able to improve the financial position of public sector banks significantly.
    - Many of them have **higher levels of stressed assets than private banks,** and also lag the latter on profitability, market capitalization and dividend payment record.
- **Part of a Long-Term Project:**
    - Privatisation of two public sector banks will **set the ball rolling for a long-term project** that envisages only a handful of state-owned banks, with the rest either consolidated with strong banks or privatised.
        - The initial plan of the government was to privatise four. Depending on the success with the first two, the government is likely to go for divestment in another two or three banks in the next financial year.
    - This will **free up the government,** the majority owner, from continuing to provide equity support to the banks year after year.
        - Through a series of moves over the last few years, the government is now left with 12 state-owned banks, from 28 earlier.
- **Strengthening Banks:**
    - The government is trying to **strengthen the strong banks and also minimise their numbers** through privatisation to reduce its burden of support.
- **Recommendations of Different Committees:**
    - Many committees had proposed bringing down the government stake in public 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.
- **Creation of Big Banks:**
    - One of the objectives of privatisation is also to **create big banks**. Unless privatised PSBs are merged with existing large private banks, they cannot ultimately attain the kind of scale and size to develop higher risk appetite and lending capacity.
    - Hence, privatisation is a multifaceted task considering all angles to tackle multiple challenges and exploring new ideas but it can pave the way for developing a more sustainable and strong banking system benefitting all stakeholders.

## What are the Related Issues?

- **Rewarding Crony Capitalism:**
    - The privatisation of the PSBs is **tantamount to selling the banks to private corporates**, many of whom have defaulted on loans from the PSBs, and will only reward crony capitalism.
- **Job Losses:**
    - The privatisation will also **result in job losses, branch closures and financial exclusion.**
    - The privatisation will shrink employment opportunities for **Scheduled Castes**, **Scheduled Tribes** **and** **Other Backward Classes (OBC)** since the private sector does not follow reservation policies for the weaker sections.
- **Financial Exclusion of Weaker Sections:**
    - The private sector banks **concentrate on the more affluent sections of the population and the metropolitan/urban areas, leading to financial exclusion** of weaker sections of the society, particularly in the rural areas.
        - Public sector banks were taking banking to the rural areas and ensuring financial inclusion.
- **Bailout operation:**
    - Bank unions have termed the **privatisation process a "bailout operation" for corporate defaulters.**
    - Private sector is **responsible for the huge bad loans.** In fact, they should be punished for this crime. But the government is rewarding them by handing over the banks to the private sector.

## Way Forward

- The governance and management of PSBs has to improve. The way to do this was outlined by the **PJ Nayak committee**, which recommended distancing between the government and top public sector appointments (everything the Banks Board Bureau was supposed to do but could not).
- Rather than blind privatisation, **PSBs can be made into a corporation like** Life Insurance Corporation (LIC). While maintaining government ownership, this will give more autonomy to PSBs.

### UPSC Civil Services Examination, Previous Year Question

**Q. In the context of governance, consider the following: (2010)**

1. Encouraging Foreign Direct Investment inflows
2. Privatization of higher educational Institutions
3. Down-sizing of bureaucracy
4. Selling/offloading the shares of Public Sector Undertakings

**Which of the above can be used as measures to control the fiscal deficit in India?**

(a) 1, 2 and 3
(b) 2, 3 and 4
(c) 1, 2 and 4
(d) 3 and 4 only

**Ans: (d)**

**Exp:**

- In general, fiscal deficit occurs when the total expenditures of the government exceed its revenue. The government takes various measures to reduce the fiscal deficit such as increasing tax-based revenue, reducing subsidies, disinvestment, etc.
- Downsizing of bureaucracy as well as selling/ offloading the shares of public sector undertaking directly contributes to reduction in fiscal deficit.
- Without knowing the destination and the effect of FDI inflows, it is difficult to determine its actual impact on the fiscal deficit. Privatisation of higher educational institutions may improve the situation but its impact may not be effective in reduction of fiscal deficit.
- Hence, statements 3, 4 are correct and statements 1, 2 are not correct. Therefore, option (d) is the correct answer.

**Source: TH**