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**“Strengthening state-owned banks**

**We need to eliminate government interference in public sector banks”**

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State-controlled banks in India have stressed assets including on performing assets and restructured loans of over Rs 7 lakh crores, though not all may be bad debts. NPAs rose from 5.20% to 6.03% from March to June 2015.

Why are there such huge poor assets with state-owned banks, so that some banks like Kotak have more assets than 10 state-owned banks together? State-owned banks have boards that are packed with nominees of Ministers and bureaucrats. Banks enjoy limited independence in decision-making especially in lending and collecting from important borrowers. Government gave generous debt-equity ratios ranging from debt at 70 to 80% with the equity many times being siphoned off by promoters at the construction stage instead. Numerous government

approvals were delayed and projects overshot time frames and amassed huge over expenditures. For example over 25000 MW gas based power capacity worth perhaps Rs 150000 crores is lying stranded. The money belongs to the state owned banks who lent it. Then there is crony lending to favoured parties without consideration of the risks.

Indira Gandhi nationalized banks and insurance in 1969 ostensibly to extend banking to rural areas and households as well as to enlarge the credit recipients to agriculturists, medium and small industries, and small borrowers. It was to prevent misuse, of public savings by the bank owners and to ensure that bank credit was available all over India. In the event, little of this happened. Rural branches remained few and there is wide extension of banking to rural households only in 2015 thanks to the BJP's Jana Dhan Yojana. Banks have accumulated huge bad debts, non performing assets and have restructured some of them and are waiting for them to perform.

Nationalization of banks and running them by the state has been a failure. It has restricted the growth of credit and not deepened the availability of funds. It has led to large borrowers becoming nonchalant in repayment of borrowings because of their connections in government. The average

capitalization at state banks is even worse when adjusted against a significant stressed asset stock and low-to-moderate provision cover. Rating agencies have dire assessments of the Indian state owned banking which is the dominant element.

The capital requirements of the state owned banks are around Rs 200000 crores. The government announced capital infusion of Rs 70,000 crore over the next four years. It has provided RS 25,000 crores in the 2016 Budget. The Finance Minister promises to give more but does not say where he will get the funds from, given that the deficit is already at the targeted level. Current fiscal.

Fitch has said: "Weak capitalization and challenges from poor asset quality are to remain significant issues for India's state banks through the medium-term." FM has said that banks will raise Rs 1.1 lakh crore by tapping markets. This may not be sufficient due to weak asset quality and persistently low equity valuations. Markets may not support this equity raising.

In the Budget the FM announced that banks will be consolidated, top management will be reviewed and new people brought in, changes in SARAFESI act are proposed to help Asset Reconstruction Cos to do better, but the details have to be worked out. "The

first and immediate agenda is to strengthen the banks. We will strengthen them by recapitalizing the banks," (FM)...And thereafter we are willing to look at consolidation among subsidiaries, consolidation of subsidiaries with the principal bank, consolidation of a weak bank to a strong bank". But government will remain the dominant shareholder. Over the long run, he said, the government will bring down stake in public sector banks to 52 per cent.

These steps will not revive state run banks and expand and deepen their ability to service an economy that must expand. What is needed is to eliminate any government interaction with banks in their operations. That must be left to the regulator, the Reserve Bank of India. There must be a set time frame to bring down government shareholding so that Boards can be autonomous and govern the banks. Privatizing some would be a good move, subject of course to tight regulation. Ensuring that borrowers service and repay loans must be a top priority and be enforced. This may mean that some borrowers may have to be sold to others. Recruitment to banks must be open and not closed to 'insiders'. Rewards and penalties for performance

must be laid down and implemented. Banks should not be made to do “priority sector lending” a major cause of bad loans. If it has to be done, government must give the funds to banks for the purpose.

Perhaps a separate Banking Regulator as part of the RBI (if possible a separate Constitutional authority), might strengthen the regulation for all banks. What is clear is that this Finance Minister has barely touched the surface of the problems and their solutions. It only reinforces the view that the Modi government’s economic policies are those of the congress and they cannot think differently.

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