53 years for India’s Bank Nationalisation

July 29, 2022

Manifest Pedagogy:

Over half a century since Indira Gandhi nationalised 14 public sector banks, the move still evokes sharp divisions, with some criticising it as a failure and others hailing it as a landmark decision. The government is carrying out a lot of reforms in the PSBs, including the EASE reforms—which are now in the 5th year. This has resulted in positive results. All the PSBs were in profit as on March 2022 and there has been perceptible improvement in their asset quality, too. It is time right people are placed at right places in the nationalised banks for better results and to carry out more reforms, instead of privatising them.

In News: The week gone by marked the 53rd anniversary of the day 19 July 1969 Prime Minister Indira Gandhi nationalised 14 major banks, which accounted for over 80 per cent of India’s bank deposits.

Placing it in Syllabus: Economy

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Current Dimensions

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Content

More on news

- Nationalisation is the process in which the government of a country or a state takes control of a specific company or industry.
- On July 19, 1969, the then government nationalised the 14 largest private commercial banks.
  - 14 banks that were nationalised banks in 1969: Allahabad Bank, Canara Bank, United Bank of India, UCO Bank, Syndicate Bank, Indian Overseas Bank, Bank of Baroda, Punjab National Bank, Bank of India, Bank of Maharashtra, Central Bank of India, Indian Bank, Dena Bank and Union Bank.
- The significant impact of the change was the expansion of banking into the rural areas, as banks started coming out of cities and began moving to towns and villages.
- Initial Attempts of Nationalisation
  - Nationalisation of banks had also taken place prior to 1969. The Reserve Bank of India (RBI) was nationalised a year after Independence.
  - The State Bank of India (SBI) came into being after the government took over the Imperial Bank of India in 1955.

Need for Bank Nationalisation

- **Socio- Economic-** To reduce the poverty rates nad to improve the standard of living by ensuring access to banking and chea credit services.
- **Concentration of wealth**-Banking institutions are instruments which help to concentrate economic power and wealth in the hands of a few persons.
- **Huge underprivileged population**-The banking system was not very suitable for the large economically underprivileged section of the society that enlisted after independence.
- **Low Banking penetration**-Before Nationalistaion only 8,000 bank branches in the country and there was one

bank branch for 65,000 people.

- **Urban-Rural divide**-Till 1968, all private banks in India were limited to big cities only.
    - All of them were monopolised by industrialists, with the share of industry in the credit disbursed by private banks doubling between 1951 and 1968 from 34 per cent to 68 per cent, while Reducing regional imbalance to curb the urban-rural divide
    - Only 5,000 of the 6,38,000 villages had bank branches, including a cooperative bank branch.
  - **Agriculture under supported**-agriculture was receiving less than 2 per cent of the total credit.
  - **Lower credit devolution**-Domestic credit to private sector, as % of GDP, was below 10% before nationalisation.

- **Other Factors**
  - There were two wars (with China in 1962 and Pakistan in 1965) that put immense pressure on public finances.
  - Two successive years of drought had not only led to food shortages but also compromised national security because of the dependence on American food shipments (PL 480 program).

Controversy with respect to Bank Nationalisation

- The Indira Gandhi government faced resistance from both the opposition and the judiciary.
- In February 1970, the Supreme Court reversed the government's decision with 10 of 11 judges striking down the **Banking Companies (Acquisition and Transfer of Undertakings) Ordinance, 1969**, through which the state had taken over control of the 14 banks.

- But Indira Gandhi passed another ordinance soon after the apex court's ruling. Subsequently, Parliament passed the **Banking Companies (Acquisition and Transfer of Undertakings) Bill, 1970**, in March that year.

Significance of Bank Nationalisation

- The nationalisation move did trigger a short-term improvement in some weaker sectors.
- **Banking penetration improved**-Now, there is a bank branch for every 9,000 people.
- **Banking in rural areas**-The rural deposit share reached **15.5 per cent in March 1991, from 6.3 per cent** in December 1969, and the **credit share increased from 3.3 per cent to 15 per cent**.
  - According to **'Golden Jubilee of Bank Nationalisation**: Taking Stock', a report from the Economic Survey 2019-20, rural bank branches increased 10-fold and credit to rural areas increased from **Rs 115 crore to Rs 3,000 crore between 1969 and 1980**
  - Besides, there are ATMs, other service outlets, banking correspondents and, of course, the pay phones and a plethora of other digital devices.
- **Green revolution**-Nationalisation also strengthened the Green Revolution. Its aim was to make the country self-reliant in food security.
  - Credit to the agriculture sector increased 40-fold from Rs 67 crore to Rs 2,767 crore.
- **Gross domestic savings** almost doubled as a percentage of the national income in the 1970s.
- **Domestic credit to the private sector**, as % of GDP, has gone up to 55% now.
- **Direct benefit Transfer**-Under the Jan Dhan Yojana mooted by Prime Minister Narendra Modi, which was launched in August 2014, more than 44 crore no-frills accounts (55% of which belong to women) have been opened and there is

a credit balance of over Rs 1.30 trillion in these accounts. This has revolutionised our direct benefit transfer scheme

- As per the government data, as many as 98% of these accounts were opened by the state-run banks.

- **Fight against black money**-During demonetisation, the PSB branches rose to the occasion and served their customers/general public, working for long hours, often late into night.
- **Health Crisis**-During the pandemic, most of the PSB branches extended normal banking services notwithstanding the associated risks to the lives of their staff.
    - Thousands of employees, including very young ones, were infected and could not survive.
- **New objective**-Nationalisation has shifted banking from ‘class banking’ to ‘mass banking’ (social banking).

Issues with Bank Nationalisation

- **Rising NPA’s**-In the long term, half a century after the nationalisation in 2019, public sector banks (PSBs) accounted for gross Rs **7.4 lakh crore of NPAs (Non-Performing Assets) or 80 per cent of NPAs** in the Indian banking system.
    - NPAs of the PSBs increased to Rs 5.40 lakh crore in 2021 from Rs 2.24 lakh crore in 2014.
- **Loss Making**-The **PSBs registered a collective loss of Rs 66,100 crore** in contrast with the profit of Rs 42,100 crore of other scheduled commercial banks.
    - Nationalisation has led to a decline in the efficiency and profitability of banks.
- **Limited Success**-Since 2014-15, almost the entire growth of the banking sector is attributable to the private banks and the largest PSB, SBI.
- **Finance burden on the government**-Between 2010-11 and

2020-21, the government infused **$65.5 billion (Rs 5.2 lakh crore) in the PSBs** to fight the NPA crisis but the situation was still bad compared to the private sector.

- **Private Banks overtaking Public banks**-PSBs (including SBI) in 1991-92 had an 88.5 per cent share in the total banking assets, and private banks began with just 4.2 per cent.
    - This number changed drastically in three decades. By 2020-21, the PSB share fell to 59.8 per cent and that of private banks rose to 32.8 per cent.
- **Low efficiency**-Lack of responsibility and initiative, red tape, and excessive delays have become common features of nationalised banks.
- **Reduced competition**-Nationalisation of banks has reduced the competition among banks to a great extent. At the same time, it has greatly increased political interference and bureaucracy in the functioning of the banking system.

Present Stand of the Government

- The present government has been moving towards privatisation and mergers in the banking sector.
    - In 2016, the then finance minister proposed the merger of five associate banks of SBI with the banking behemoth.
    - In 2019, state-owned Bank of Baroda became India’s third-largest lender after a merger with Vijaya Bank and Dena Bank.
- In one of the government’s biggest reforms, it announced the mega merger of 10 PSBs into four entities
- The government announced in the 2021-22 Union Budget the privatisation of two PSBs.
    - There are now reports that the government is planning to initiate the next round of PSB mergers, with the aim to create four-five large banks of the scale of SBI.

Way Forward

- **Rationalisation**-Former Niti Aayog vice-chairman and the NCAER chief has recommended that all PSBs barring SBI be privatised.
- **Privatisation alone is not a solution**-The government should not rush with the privatisation of banks, rather it should focus on comprehensive governance reforms, because if the banking sector is run by independent boards and in a dynamic manner, then public sector banks can also work like any other private bank.
- **Reforms**-EASE reforms to make Banking more customer friendly experience.
- **Limited number of large banks**-The Narasimham Committee Report (1991), emphasised that India should have three or four large commercial banks, with domestic and international presence, along with foreign banks.
  - The second tier may comprise several mid-size lenders, including niche banks, with economy-wide presence.
- **Differentiated Banking**-Though the universal banking model has been widely preferred, there is a need for niche banking to cater to the specific and varied requirements of different customers and borrowers.
  - Essentially, these specialised banks would ease the access to finance in areas such as RAM (retail, agriculture, MSMEs).
- **Risk Management and regulations**-The government should tighten the loose ends by allowing them to build diversified loan portfolios, establishing sector-wise regulators, bestowing more powers to deal effectively with wilful defaulters.
- **Mitigate moral hazard**-Focus on the need for higher individual deposit insurance and effective orderly resolution regimes to mitigate moral hazard and systemic risks with least cost to the public exchequer.

Mould your thoughts

1. Nationalisation of banks was a failed attempt to achieve socio-economic objectives and to reform the banking ecosystem in the country. Critically Analyse. (250 words).

Approach to the answer.

- Introduction about bank nationalisation.
- Need of nationalisation
- Success of nationalisation.
- Issues associated with nationalisation.
- Way Forward and conclusion.