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GOLDEN RESEARCH THOUGHTS

ROLE OF PUBLIC SECTOR BANKS IN INDIA

Warwante Surendrakumar Vasantrao
Research Scholar , Tq. Basmat Dist. Hingoli .

ABSTRACT

So far we have dealt with the banking system as a whole. We now take up separately the public sector banks i.e., the banks owned by the government. These banks came under the ownership of the government in two phases. In the first phase, in 1969, banks with deposits of ₹ 50 crores or more, were nationalised. In the second phase in 1980, banks, with deposits exceeding ₹ 20 crores, were taken over by the government. Thus it is the big banks in the private sector which became the public sector banks.

KEYWORDS: *banking system , public sector banks.*

INTRODUCTION

We discuss the rationale of nationalizing the private banks. We also refer to the achievements of these banks as also their weaknesses. Measures to improve their working, as recommended by the Narasimhan Committee, have also been described at the end of the chapter.

NATIONALIZATION : PROS AND CONS:

Several reasons have been put forward in favour of the public sector banks. At the same time, provision has also been made for the existence and expansion of the banks in the private sector. We discuss the main arguments as under.

PROMOTING SOCIAL OBJECTIVES:

The basic argument, often advanced to clinch the issue in favour of nationalization, is that it is only when government .owns banks that it can fulfil its economic/social obligations. These pertain to various aspects of life of a country. In the context of India, these can be summarized as falling under the following four heads, mostly flowing from the Indian Constitution, the various plans and the preferences of the government, from time to time. *One* is the need to fulfil the objective of planned development. It requires large financial resources and a command of financial institutions. It is also necessary that the distribution of credit is made as per plan priorities. It is argued that since the total pool of funds is very limited planning authority cannot allow allocation of funds in terms of market preferences only. *Two,* efforts of the government to assist the weak sectors and weak sections of population can be supplemented substantially by diverting a part of bank funds to them in their productive activities liberally and a concessional rates only by government having a full control of these funds. *Three,* evils of concentration of economic power, arising from the use of substantial portion of funds by a few private entrepreneurs, and the attendant corrupt practices associated with monopolies, etc., can be done away and effectively only by denying a major part of this field to the privates; sector; *Four,* the promotion of banking facilities to unbanked/ underbanked areas is possible only by government owning these banks.

Failings of market: The arguments that social, objectives cannot be fulfilled by letting private enterprise own banks is further sought to be strengthened by pointing out the shortcomings of the market. It is asserted that market does not even register these objectives, much less pursue them. In support of this contention, several aspects of the functioning of market are pinpointed to prove its inadequacy in this respect.

1. It is pointed out that market, being imperfect, cannot achieve even those objectives often associated with competitive market. For example, as pointed out by Keynes in his *A Treatise on Money* (Vol. II) in respect of the UK that no one offering adequate security can get as much loan as he wishes by simply outbidding other on payment of interest. The amount he can get depends also upon other factors like borrowers' purposes and his standing with the bank as a valuable or influential client. This makes bank-management decisive in the matter. Again, as a proof of imperfection in money market, one can cite professor Kalecki in his *Theory of Economic Dynamics* who stresses the point that the extent and ability to borrow is linked with capital that is already in the possession of entrepreneurs. Thus in order to prove upon allocation of funds even strictly on market consideration, government interference is lied for. In other words, traditional monetary policy, lich concerns itself only with the overall limits a bank credit within the specified range of interest, is t enough. It has to be expanded to include the question of choosing borrowers who will use funds d the purpose for which these will be used.

2. The point is made that in India commercial anking, following conventions in the UK, Concentrates on short-term lending, and shows very little interest in direct finance of long-term investment. Again, the soundness of loans is by and large determined by the security offered by borrowers as also the period for which they are required. As a result, there have developed rules of thumb for the safety of bank business. But these "could be seriously in conflict with the larger economic and fiscal considerations which should govern the distribution of the investable resources in an economy."

3. Private banks may not be prepared to bear costs of lending to small enterprises. These costs like risk involved, including their maintenance of large number of small accounts, keeping in constant touch with customers, etc., may, however, be socially justified. Even if there are some defaults, and operations somewhat costly, these may in the long-run, and in the context of overall benefits to the economy, be more than offset. These considerations are, however, long run in nature which the private banks do not take into consideration.

INEFFECTIVENESS OF LEGISLATIVE REGULATION AND CONTROL:

It is also argued that the alternative method of regulating banks through legislation and control, broadly termed socialization, is not of much help. The reasons advanced are many. The small enterprises in agriculture and industry, potentially most productive in underdeveloped countries like India, are denied adequate bank funds, despite all incentives and encouragement to them because these are not "sound" in commercial banking parlance. Again, it is pointed out that the rule of profit maximization in private enterprises has prevented them from helping rural people, in spite of the many promptings done by the government. The reason is simple: bank profits, being dependent upon the proportion of their earning assets to the idle cash reserves they have to hold, are higher, the larger the proportion. Hence in case of customers, who are educated and have well- developed banking habits and therefore are accustomed to using and receiving cheques in settlement of transactions, the need to hold cash reserves is less than in case of illiterate people who are not much familiar with the use of bank deposits and therefore insist on cash payments. It follows that in the case of private banking, there is an inbuilt bias in favour of cities and big towns and against rural areas and small towns. These banks are interested in small towns or villages only to get deposits on more permanent basis such as saving deposit, but not in extending lending facilities to them.

PLACE OF PRIVATE BANKING:

While a case is made for nationalized banks, quite a few pro-public sector economists also concede a place for private banks. The field they earmark for them is decided in terms of the following three main criteria. *First,* having nationalized a major segment of the banking set-up so as to acquire a decisive say in respect of the large portion of bank funds, the residue can be left to the private sector. This residue will, of course, vary with time and circumstances. *Secondly,* private banking is justified because it is free of bureaucratic elements which introduces rigidity in decision-making. *Thirdly,* it is stated that private sector banks be allowed only if and so long these remain small. It is only then that these will be useful to men of small means. This also implies elimination of private monopoly and reduction in the concentration of economic power. *Fourthly,* there are certain requirements that small banks can more easily fulfil than big banks. For example, collection of saving from people of different areas, of financing real estate business like housing, etc., can be more effectively achieved by small banks. It is for these reasons that in the USA, the proportion of time deposits with the small banks is larger than in the case of big banks, and that the investment projects of local interest like housing are undertaken more by these banks. *Fifthly,* it is pointed out that with the help of the small banks, it may be more practicable to assimilate indigenous banks, and even moneylenders rather than designing separate schemes for their integration with the banking system.

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ACHIEVEMENTS OF PUBLIC SECTOR BANKS:-

These banks have performed a variety of functions to fulfil the economic and social objectives of the country. In fact, the responsibilities these banks have undertaken, have no parallel anywhere in the world.

PUBLIC ORIENTATION:

These banks, in more than one way, have promoted the public interests. These banks have, for example, provided banking facilities in the hitherto unbanked/underbanked areas. By opening a major proportion of new bank offices in the rural and backward states, they have done a commendable job in reducing regional imbalances as among states, as also between rural and urban areas. At the same time, these banks have, by allowing people with small incomes to open accounts, promoted the banking-habit among the masses.

A considerable proportion of their resources has also been devoted to the furtherance of the economic and social ends. For example, quite a significant amount of saving (or deposits) mobilised by them has gone to the government for the finance of development projects. By raising the statutory liquidity ratio (SLR) to a high level for a number of years, the government received large funds for development. Funds are also made available through the banks by participating in the government's borrowing programmes, and that too at very low rates of interest. Banks also provide a sizeable proportion of their credit for such government activities as the procurement of foodgrains (for public distribution system), raw cotton and raw jute, again at, concessional rate of interest. Banks also make available upto 40 per cent of their credit to the priority sectors. Besides, much, by way of loans at low rates, has been done in the implementation of such pro-poor programmes as Special Area Development Programmes. Integrated Rural Developmen Programmes etc.

LARGE EXPANSION:

Apart from the significant qualitative progress mentioned above, these banks have expanded rapidly in quantitative terms also. The number of bank-offices (comprised of State Bank of India and Associates, 19 nationalised banks and regional rural banks) increased from 7051 in 1969 to 62,045 in 2005 *i.e.,* by more than 8 times. Of the total bank offices, as many as about 51 per cent are located in rural areas. Their deposits during this period increased from ₹ 3896 crore to ₹ 1139 thousand crore *i.e.,* to more than 292 times. The credit-extended by them also rose from ₹ 3036 crore to ₹ 6,19,660 crore *i.e.,* to about 204 times. Of the total bank credit the share of the priority sector went up from about *15* per cent to 37 per cent.

WEAKNESSES OF PUBLIC SECTOR BANKS

Despite impressive achievements, the public sector banks are beset with a number of serious problems,, These are eroding their commercial viability, as also hindering them in allocating funds in the most productive lines.

One problem, for example, is that of huge overdues, estimated at 16 per cent of the total advances of banks (1998-99). Since these loans are not returned, these cannot be recycled by the banks. As such these represent a waste of considerable amount of financial capital. Called non-performing assets, these limit the capacity of banks to expand credit. *Two,* the efficiency of the banking operations too is at a very low level. This is evident from the rise in the costs of banking transactions, and the poor quality of large many projects financed by banks. *Three,* the low profits of several banks, and losses of some banks have eroded their financial soundness.

These weaknesses have been caused by several factors. One major cause is the government policies of directing credit to certain activities (like priority sectors, procurement of food etc.) and to certain people (poor farmers, artisans etc.) at concessional rates. The costs, instead of being met from the government budget, have been borne by the banks, by charging higher interest from others. The lack of autonomy in respect of the deployment of funds also permeated other aspects of banking such as recruitment of personnel, their emoluments, opening of branches etc. Again, the banks have, for long, operated in an environment marked by such negative features as : lack of competition; use of bureaucratic procedures and practices; little provision for appraisal and monitoring of projects etc., little incentives for transparency in house-keeping or in the preparation of balance sheets etc. Currently, these banks are getting into difficulties of various types because of the economic reforms which aim at extending the free market, reducing the government Controls, and globalising the economy.

CONCLUSION:-

To sum up, the case for the public sector banks rests on the ground that these can play a great role in fulfilling the socio-economic objectives of the country. The public sector banks, as stated in the Act nationalizing the banks, are “to control the heights of the economy and to meet progressively, and serve better the needs of development of the economy in conformity with national policy and objectives.” While this is so it is also agreed that there is need for small private banks for small areas to mobilize savings and finance projects of local interest

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