Bank Nationalisation - 44 years of Socio-Economic Justice in India

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Abstract: After independence the Government of India (GOI) adopted planned economic development for the country (India). Accordingly, five year plans came into existence since 1951. This economic planning basically aimed at social ownership of the means of production. However, commercial banks were in the private sector those days. In 1950-51 there were 430 commercial banks. The Government of India had some social objectives of planning. These commercial banks failed helping the government in attaining these objectives. Thus, the government decided to nationalize 14 major commercial banks on 19th July, 1969. All commercial banks with a deposit base over Rs.50 crores were nationalized. It was considered that banks were controlled by business houses and thus failed in catering to the credit needs of poor sections such as cottage industry, village industry, farmers, craft men, etc. The second dose of nationalisation came in April 1980 when banks were nationalized.

Keywords*:* Mixed Economy, Rational Allocation, Agricultural Sector, Commercial Banks

Introduction

After Independence India adopted a socialist pattern of economy as its goal. The aim was to achieve a society with wealth distributed as equitably as possibly but ensuring that the government does not acquire a totalitarian role. The Government of India wished to play an active role in the economic life of the nation and with this the government adopted a mixed economy. The two sectors, private and public were allowed to function independently of each other. The private sector was regulated through a system of checks and balances such as regulations, licenses controls and legislations. The public sector was allowed to grow through setting up of institutions and industries and nationalization of some belonging to private sector who failed to achieve the desired result of growth of the economy.

Considering this basic objective in mind the government decided to nationalize the banks in an attempt to monitor and exercise some control over the banking sector. The motives for nationalization are both political and economic. It is the process whereby the means of production, distribution and exchange are owned by the state on behalf of the people or working class to allow rational allocation of output, consolidation of resources, rational planning or control of the economy. This enables the government to exercise full democratic control over the means thereby ensuring effective means of distribution of output to benefit the public at large.

The nationalization of banks in India was primarily done for two reasons. First, the partition of India in

1947 adversely affected the banking activities especially in Punjab and West Bengal. The laissez faire regime was brought to an end and the government started to play an active role in the reconstruction of the economy especially banking and finance. Secondly, the government believed that the ownership of the Bank by the sovereign will give new confidence to the customers and that it would dispel the suspicions existing in the minds of the people with regards to the capabilities of the bankers in the private sector.

In the year 1948, the Reserve Bank of India, India's central banking authority was nationalized and it became an institution owned by the government of India. In a further attempt to control the banking activities the government enacted the Banking Regulation Act, which authorized the RBI to regulate, control and inspect the banks in India. The act provided that no bank could be opened without the sanction of RBI and that no two banks can have the same directors. Then in the year 1955, the government took another major step and nationalized the Imperial bank of India and its undertaking was taken over by State Bank of India.

However, the scheduled banks were accused of directing their advances to the large and medium scale industries and big business houses and the sectors such as agriculture, small scale industries and exports were not receiving their due share. Keeping this mind in February 1966, a scheme of Social Control was setup whose main function was to regularly assess the demand for credit from various sectors of the economy, to determine the needs of the economy and prioritize grant of loans and advances to ensure optimal allocation of resources. The main feature of this scheme was the establishment of a National credit council headed by the Finance Minister and representatives of agricultural sector, trade, industry, banks and professional groups as the members.

This scheme was challenged by the banking industry representatives who argued that social control was not necessary since the RBI had already been vested with effective and extensive powers over almost every aspect of banking. However, this scheme failed to provide any remedy and therefore even though the number of banks were opened in the rural areas the private banks were still not oriented towards meeting the credit requirements of the weaker sections.

Since the social control had failed to meet its objective, on 19th July 1969, fourteen Major banks each having deposits of more than 50 crores and having between themselves aggregate deposits of Rs. 2,632 crores with 4130 branches were nationalized. This process of bringing the banks under the government control was considered nothing short of a revolutionary step and marked the beginning of a co-ordinated endeavour to use an important part of the financial mechanism for the country's economic development.

Nationalisation of Banks in India

After independence the Government of India (GOI) adopted planned economic development for the country (India). Accordingly, five year plans came into existence since 1951. This economic planning basically aimed at social ownership of the means of production. However, commercial banks were in the private sector those days. In 1950-51 there were 430 commercial banks. The Government of India had some social objectives of planning. These commercial banks failed helping the government in attaining these objectives. Thus, the government decided to nationalize 14 major commercial banks on **19th July, 1969**. All commercial banks with a deposit base over Rs.50 crores were nationalized. It

was considered that banks were controlled by business houses and thus failed in catering to the credit needs of poor sections such as cottage industry, village industry, farmers, craft men, etc. The second dose of nationalisation came in **April 1980** when banks were nationalized.

Objectives behind Nationalisation of Banks in India

The nationalisation of commercial banks took place with an aim to achieve following major objectives.

1. **Social Welfare** : It was the need of the hour to direct the funds for the needy and required sectors of the Indian economy. Sector such as agriculture, small and village industries were in need of funds for their expansion and further economic development.
2. **Controlling Private Monopolies** : Prior to nationalisation many banks were controlled by private business houses and corporate families. It was necessary to check these monopolies in order to ensure a smooth supply of credit to socially desirable sections.
3. **Expansion of Banking** : In a large country like India the numbers of banks existing those days were certainly inadequate. It was necessary to spread banking across the country. It could be done through expanding banking network (by opening new bank branches) in the un-banked areas.
4. **Reducing Regional Imbalance** : In a country like India where we have a urban-rural divide; it was necessary for banks to go in the rural areas where the banking facilities were not available. In order to reduce this regional imbalance nationalisation was justified:
5. **Priority Sector Lending** : In India, the agriculture sector and its allied activities were the largest contributor to the national income. Thus these were labeled as the priority sectors. But unfortunately they were deprived of their due share in the credit. Nationalisation was urgently needed for catering funds to them.
6. **Developing Banking Habits** : In India more than 70% population used to stay in rural areas. It was necessary to develop the banking habit among such a large population.

Demerits, Limitations - Bank Nationalisation in India

Though the nationalisation of commercial banks was undertaken with tall objectives, in many senses it failed in attaining them. In fact it converted many of the banking institutions in the loss making entities. The reasons were obvious lethargic working, lack of accountability, lack of profit motive, political interference, etc. Under this backdrop it is necessary to have a critical look to the whole process of nationalisation in the period after bank nationalisation.

The major limitations of the bank nationalisation in India are:-

1. **Inadequate banking facilities** : Even though banks have spread across the country; still many parts of the country are unbanked. Especially in the backward states such as the Uttar Pradesh, Madhya Pradesh, Chhattisgarh and north-eastern states of India.
2. **Limited resources mobilized and allocated** : The resources mobilized after the nationalisation is not sufficient if we consider the needs of the Indian economy. Some times the deposits mobilized are enough but the resource allocation is not as per the expansions.
3. **Lowered efficiency and profits** : After nationalisation banks went in the government sector. Many times political forces pressurized them. Banking was not done on a professional and ethical grounds. It resulted into lower efficiency and poor profitability of banks.

4. **Increased expenditure** : Due to huge expansion in a branch network, large staff administrative expenditure, trade union struggle, etc. banks expenditure increased to a dangerous levels.

5. **Political and Administrative Inference** : Many public sector banks badly suffered due to the political interference. It was seen in arranging loan meals. It ultimately resulted in huge non-performing assets (NPA) of these banks and inefficiency.

Regional Spread of Banking

Like many other socio-economic indicators, banking indicators also are not uniform across regions in India. Lower value of population per office indicates higher banking density. It is observed that the banking density is significantly higher in the Southern, Northern and Western Region as compared with North-Eastern, Central and Eastern Region (Table 1). Further, the banking density has deteriorated more in the North-Eastern, Central and Eastern Region, where it was already low, in the decade since 1996.

In the context of regional spread of SCBs, it is observed that of the 6,320 offices opened since 1996, 4,925, or more than three quarters, have been in the Southern, Northern and Western Region while the other three regions, North-Eastern, Central and Eastern Region taken together, have accounted for less than a quarter (Table 2). As a result, the latter regions, individually and collectively, now account for a lower share of SCB offices as compared with that a decade ago.

Table 1: Region-wise Banking Density

Population per Office ('000)

Region	**1996**	**2006**	**Change**
1	**2**	**3**	**4**
Northern Region	11.9	12.6	0.7
North-Eastern Region	18.4	21.7	3.3
Eastern Region	17.8	19.9	2.1
Central Region	17.4	20.2	2.8
Western Region	13.7	14.9	1.2
Southern Region	12.2	12.2	0.0
All India	**14.7**	**15.9**	**1.2**

Source: Own computations based on BSR, RBI and National Accounts Statistics, Government of India. (NAS) (Various Issues).

It is believed in general that financial development is robustly and positively related to economic development. In India, various regions have shown diverse economic growth and are at different levels of socio-economic development. As a consequence, they may be expected to show different levels of banking penetration. In view of this, emphasising only on banking density (defined in terms of population per office) may not be adequate to highlight the extant disparity in banking spread across regions. Accordingly, Table 3 presents the data on region-wise credit from the SCBs as a ratio of regional GDP. The bank Credit-GDP ratio varied from 13.2 per cent in the North-Eastern Region to 76.6 per cent in the Western Region in 2006. There was considerable variation in the region-wise credit-deposit ratio also. The highest credit-deposit ratio was found in the Western Region (92 per cent) closely followed by the Southern Region (84.4 per cent). However, Southern Region was distinctly ahead in terms of the proportion of population having credit account as compared with other regions. Overall, it appears that the spread and depth of banking is much higher in the Southern, Western and Northern Regions as compared with their North-Eastern, Central and Eastern counterparts even after accounting for diverse economic growth and development across regions.

Table 2: Regional Spread of Banks

(No. of Offices of SCBs)			
Region	**1996**	**2006**	**Change**
1	**2**	**3**	**4**
Northern Region	10,021	11,821	1,800
	(15.5)	(16.7)	(28.5)
North-Eastern Region	1,936	1,949	13
	(3.0)	(2.8)	(0.2)
Eastern Region	11,686	12,308	622
	(18.1)	(17.4)	(9.8)
Central Region	13,344	14,104	760
	(20.7)	(19.9)	(12.0)
Western Region	9,938	10,996	1,058
	(15.4)	(15.5)	(16.7)
Southern Region	17,531	19,598	2,067
	(27.2)	(27.7)	(32.7)
All India	**64,456**	**70,776**	**6,320**
	(100.0)	**(100.0)**	**(100.0)**

Note: Figures in bracket represent share in all-India.
Source: BSR (Various Issues).

Table 3: Region-wise Banking Indicators

Regions	**2006**		
	% Population having Credit Account	**Credit-Output Ratio**	**Credit-Deposit Ratio**
1	**2**	**3**	**4**
Northern Region	6.2	54.8	64.6
North-Eastern Region	3.9	13.2	40.7
Eastern Region	4.5	22.4	49.2
Central Region	4.3	21.1	44.2
Western Region	7.5	76.6	92.0
Southern Region	16.4	46.7	84.4
All India	**7.6**	**45.8**	**72.4**

Source: Computed based on data from BSR and NAS.

Table 4 reinforces an earlier point that lower expansion of banking in the last decade in North-Eastern, Eastern and Central regions does not necessarily reflect relatively lower economic growth and, therefore, lower banking opportunity in these regions. Eastern and North-Eastern Region witnessed higher than average All-India growth in their per capita income during the decade 1996-2006 but recorded much lower growth in offices of SCBs than at All-India.

An outcome of the pattern of expansion of banking during the decade 1996-2006 in terms of banking and income disparity among states is presented in Table 5. While banking disparity remained lower than income disparity, the decade witnessed rising disparity among states both in terms of banking spread and per capita income. However, the fact that the magnitude of increase in banking disparity was higher than that in income disparity in the last decade is a matter of concern. Hence, there is a need to intensify efforts towards increasing the banking outreach in the poorer regions of the country, which are less served by the formal financial network. Traditionally, banks played an integral part in the poverty alleviation programmes of the Government and thereby performed a critical role in the efforts towards inclusive growth. Recently, the SHG-Bank Linkage Programme is a major plank of the strategy for delivering financial services to the poor in a sustainable manner. This is discussed in the next Section.

Table 4: Region-wise Progress of Banking

Region	**Decadal (1996-2006) % Growth in**

	Offices of SCBs	Per Capita Income
1	**2**	**3**
Northern Region	18.0	127.9
North-Eastern Region	0.7	130.4
Eastern Region	5.3	145.7
Central Region	5.7	93.3
Western Region	10.6	123.1
Southern Region	11.8	148.5
All India	**9.8**	**127.9**

Source: Own computations based on BSR and NAS (Various Issues).

Table 5: All India Disparity@ Measures		
Coefficient of Variation (in %)		
Disparity	**1996**	**2006**
Banking	34.3	45.4
Income	43.7	53.5

@: Banking Disparity is calculated as coefficient of variation (cv) in population per office of various States. Income Disparity is calculated as cv in Per Capita Income of various States. **Source:** Own computations based on BSR and NAS (Various Issues).

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ON July 19, 1969 - forty two years ago - 14 major private banks were nationalised in India. It was what Jayaprakash Narayan, the veteran socialist-national leader of India, described the step as a "masterstroke of political sagacity", when Smt Indira Gandhi nationalized 14 Banks in 1969 and not only scored over her rivals in the Congress Party, all much senior and experienced, known as *"Syndicate"* group, but also won over the hearts of millions of Indians which made her sweep the General elections later. Let us see how bank nationalization happened and why? Today Reserve Bank of India is the central bank of the country. Central banks are a relatively recent innovation and most central banks, as we know them today, were established around the early twentieth century. The Reserve Bank of India was set up on the basis of the recommendations of the Hilton Young Commission. The Reserve Bank of India Act, 1934 (II of 1934) provides the statutory basis of the functioning of the Bank, which commenced operations on April 1, 1935.

The Bank began its operations by taking over from the Government the functions so far being performed by the Controller of Currency and from the Imperial Bank of India, the management of Government accounts and public debt. The existing currency offices at Calcutta, Bombay, Madras, Rangoon, Karachi, Lahore and Cawnpore (Kanpur) became branches of the Issue Department. Offices of the Banking Department were established in Calcutta, Bombay, Madras, Delhi and Rangoon. Burma (Myanmar) seceded from the Indian Union in 1937 but the Reserve Bank continued to act as the Central Bank for Burma till Japanese Occupation of Burma and later upto April, 1947. After the partition of India, the Reserve Bank served as the central bank of Pakistan upto June 1948 when the State Bank of Pakistan commenced operations. The Bank, which was originally set up as a shareholder's bank, was nationalised in 1949.

Despite the provisions, control and regulations of Reserve Bank of India, banks in India except the State Bank of India or SBI, continued to be owned and operated by private persons. By the 1960s, the Indian banking industry had become an important tool to facilitate the development of the Indian

economy. The Government of India issued an ordinance and nationalised the 14 largest commercial banks with effect from the midnight of July 19, 1969. Within two weeks of the issue of the ordinance, the Parliament passed the Banking Companies (Acquisition and Transfer of Undertaking) Bill, and it received the presidential approval on 9 August 1969.

A second dose of nationalization of 6 more commercial banks followed in 1980. It is easy now to take for granted, or even to dismiss or disparage, what an extraordinary and important step that was. It was not a step taken at random or because of the whims of the leadership of the time, but reflected a process of struggle and political change which had made this an important demand of the people. The political situation at that time had some eerie similarities to the present one: a weakened Congress Party, in which Indira Gandhi sought to establish her position vis-à-vis the “syndicate” of older and more established Congress leaders by enlisting the support of left elements both within and outside her party. Bank nationalisation was one fallout of this political configuration, which had been placed on the agenda by progressive movements and campaigns for this. In these struggles, incidentally, hundreds of people even lost their lives, giving some idea of the intensity of the demand and the violence of the opposition.

The government's banking policy has paid rich dividends over the last five decades, especially after 1969 when 14 major private banks were nationalised. The policy has resulted in the creation of the massive network of the banking structure in the country. The major chunk of the structure was contributed by the nationalised banks, which number 27 at present.

According to bank economists, during the last 42 years of nationalisation, the branches of the public sector banks rose 800 per cent from 7,219 to 57,000, with deposits and advances taking a huge jump by 11,000 per cent and 9,000 per cent to Rs 5,035.96 billion and Rs 2,765.3 billion respectively. Contrary to the popular belief, employee productivity has been rising in the nationalised banks over the period, the economists said. Productivity per employee in respect of business volume (both deposits and advances) has gone up from Rs 250,000 in 1969 to Rs 4,780,000 in 1993. Accordingly, profits of these banks went up to Rs 30 billion in 1993 as against Rs 90 million at the time of the nationalisation, they said. These banks also contributed to the generation of employment. Their staff strength increased by 300 per cent over the period to 900,000.

The economists said the growth of the banking sector after the nationalisation was unprecedented anywhere in the world. It is particularly true of branch expansion to every nook and corner of the country. While there were hardly any branch in the rural areas in 1969, 35,000 bank branches are operating there at present.
The need for the nationalisation was felt mainly because private commercial banks were not fulfilling the social and developmental goals of banking which are so essential for any industrialising country. Despite the enactment of the Banking Regulation Act in 1949 and the nationalisation of the largest bank, the State Bank of India, in 1955, the expansion of commercial banking had largely excluded rural areas and small-scale borrowers.

The developmental goals of financial intermediation were not being achieved other than for some favoured large industries and established business houses. Whereas industry’s share in credit disbursed by commercial banks almost doubled between 1951 and 1968, from 34 per cent to 68 per

cent, agriculture received less than 2 per cent of total credit. Other key areas such credit to exports and small-scale industries were also neglected.

Conclusion

As stated earlier, the primary reason behind the nationalization of the banks was to achieve the socialistic pattern of society. It was proposed that nationalization will enable to direct the credits to priority fields of agriculture, small scale and exports, that banking units would not expand in rural areas and there will be enhancement of public confidence. It was felt that Indian commercial banks were catering only to the large and medium scale industries who was ready to pay the money back to these banks at a higher interest rate in comparison to the rural areas. This can be evidenced by the fact that whereas industry's share in credit disbursed by commercial banks almost doubled between 1951 and 1968, from 34 per cent to 68 per cent, agriculture received less than 2 per cent of total credit.

It was strongly believed that nationalization would enable the banks to charge lower rate of interest from the weak and the backward areas and the exporting sector thereby subsidizing these sectors. The long title of 'The Banking Companies (Acquisition and Transfer of Undertakings) Ordinance, 1969 for the nationalization of the 14 banks stated that the nationalization was being done 'in order to serve the better needs of development of the economy in conformity with the national policy and objectives.'

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