Chapter 4

PUBLIC POLICY AND REFORMS IN INDIAN BANKING SECTOR

4.1 Introduction to Public Policy

Public policy is the study of intersection of public and policy which addresses the problem of masses. Here Public means the citizens of a country or a group of nation and policy is the guidelines set by the government of a country or the authority of that group. Policies are meant to address the problems which may be daily needs at house hold level or nation at large. Some policies are addressed to cater to entire humanity. Examples, some environmental policies of United Nations are bound to all membering countries. Same way, some trade policies of certain associations of nations introduced for ease of business of their membering countries or association of those countries.

Public policy has two connotations; Public and Policy. Policy in its broad terminology refers to the plan of doing the thing. Policy may be in any field, even an individual can adopt a policy to complete something. Organisations, government or private etc has policy of their own to do its business. The other word Public in Public policy refers to Government. Government is by the people and for the people, so public is always referring to its representative government. Public policy always refers to the framework within which government actions to achieve its people goals. Public policies may come from any form, it may be a law passed by parliament, a law passed by courts, and ordinance, executive orders etc. The uniqueness of these policies passed by government has complete authority on implementation. All government machineries have to support to the implementation. But the success or failure depends on the popularity of the policy and its successful implementation.

All public policies are governed by its accepted constitution. So, Public policy is a course of action or inaction adopted and pursued by a government. Public policy may start at any level, may be from top or bottom or at any level laterally. We all know how policies start from top, when government announces any new policy it will be percolated
down to different levels for implementation. Most of these policies touch people at large. Likewise, some policies may originate at village level to cater to particular people at that village or community. Policy touches people in one way or other in any form. From issuing a ration card at village level to issue of passport at cities are governed by certain policies modified to cater to address the issues.

But all these Policies touch people, they make changes to people life, it influences their way of life, gives direction to live.

Public policy involves mainly:

1. Problem or the issues of people
2. It involves People / its citizens
3. People representatives
4. Government at all level
5. Policy implementing machinery may be government, non-government or any organisation responsible for implementing the policy
6. Pressure groups

Public policy is an ingredient of all these to address an issue through introduction or modification of a rule or process to reach a desired solution. Public policy is like a game of jigsaw puzzle, understanding the problem, foresee the outcome and systematically arrange of machinery to arrive at the desired solution. Contribution to policy formulation and implementation comes from across the sphere. Every government, whether it is central or state or at root level has its own methodology to address its issues based on its set principle to act upon. The way government resolves the issue shows the character of the representatives and government in collective effort to its citizens. Public policy always revolves around its citizens, so welfare of people is prime concern shown through the policy. Government is more responsible towards its people welfare. All potential representatives during their election campaign advertise their agenda through their manifesto during their campaign. Each party has its own manifesto based on their target
group of voters. National parties focus on larger issues and regional parties on the issues bothering to their contested region. Each manifesto is based on the analysis done by the party on the issues to be addressed. So policy formulation is a science, it’s a systematic study of issue. Here the choice and selection of issues vary as per the culture and basic philosophies of the party. Actually, analysis of a policy is more of an academic exercise which is usually conducted by researchers, seeking to understand what needs to be done to address the issue.

As an academic subject, public policy embraces all the social science fields and its concepts like political science, economics, sociology, public administration, management and its operations, even mathematical analysis. Public policy as a subject draws concepts and theories, but the implementation differs from place to place, people to people. As a subject, again it completely differs from other social sciences. It has an intrinsic field of study and to cater to its circle. Policies may differ when it comes to its domestic issues and same with respect to international issues.

4.2 Different forms of Governments

Government plays a major role in formulation of policies. The form of government which it operates can determine the type of policies it is going to govern to its people. Based on the legacy, culture, socio-economic conditions, and the political environment it has gone through. To understand the policy, we need to know the type of government a country operates on. We have 196 countries around the globe embraced different form of government. Each has its own form of government, legislation, constitution to govern upon. There are many studies have been undertaken to understand the form of government from ages since civilisation. The forms of government have seen many changes since its inception and are being modified each and every day to cater to its people varied needs. A transformation from a conservative culture of government to open, fairness and transparent form of governments are encouraged across. It has become a contagious crisis to adopt a form of government which has to be welfare oriented, people centric, transparent. What happened in Egypt called as Arab Spring is the best example for people orientation to get democracy, free elections, economic
freedom, human rights etc. All these demands of people are again people oriented, welfare oriented. Arab spring was a contagious revolution spread across countries in Middle East, transformed governments.

Governments have been classified based on their principle, purpose and norms. During ancient times, Aristotle classified governments based on some principles prevailed those times. He classified as Normal type and Perverted type\(^1\). Normal type being of government considers welfare of people as their prime responsibility. On the other hand, perverted type considers individual or group interest as primate motive. Coming to modern times classifications, as per Leacock\(^2\), classifications are based on sovereign power, method of acquiring power, relationship between executive and legislature and lastly on the basis of distribution of power between center and state.

He classified based on sovereign power as Dictatorship and Democracy. In dictatorship, the absolute power vested on one single person. He is not accountable to anyone in the government, he can make or break the law. He may appoint few advisors to guide him, but the suggestions are not bound to be followed. There will be a single party under dictatorship. Democracy as we know is by the people for the people. It is an elective representation from people who administer the country.

Under methods of acquiring power by the head of the state, government is divided in to Absolute Monarchy, Constitutional Monarchy and The Republic form.

We can find monarch type of government in countries like Holy-see, Brunei, Oman, Qatar, Saudi Arabia, Swaziland, UAE and Vatican City. In extension to this, there are constitutional monarch followed in 35 countries and another 152 countries follow Republic form of government. Again, among these republics form of governments, 4 countries follow Islamic republic form of government.

Absolute monarchy and Constitutional Monarchy\(^3\) differs from republic. Absolute Monarchy is an individual source to the political power in the state and is not legally bound by any constitution of that country. It is generally comes by hereditary or through vested powers. This form of government has a long history to it. It can be traced back to
Babylonian and ancient Egypt period, where the rulers had absolute power vested on them to run the state. Mostly it was hereditary driven and kingdom was passed through generations. In India, we can see this form of government from Mauryan period to till we got freedom. On the other hand, a constitutional monarchy is a form of government in which a monarch will become the head of state under written or unwritten or sometimes blended with both form of constitution.

After second word war, in most of the countries decolonization happened giving independence to form government of people choice. Some countries got freedom after great struggle and some got freedom without struggle just after World War II. We have witnessed a huge turnaround starting from 1800, especially in Europe, 55 countries or territories were under monarchies or constitutional monarchies by starting that century. By 1914 the numbers reduced to 22 and by 2015 it is only in 12 countries we can see monarchy. Simultaneously, the number of republican states rose from 9 to 35 by 2015. Same transformation we can witness across the world.

A Republic form of government is a sovereign state, where elected individuals represent the society of citizens and administer their power and authorities as per the law of land which is formed.

Based on relationship between Executive and Legislative, government is categorized into Parliamentary and Presidential form. In democratic form where the administration is conducted by council of ministers. The popular or the party with majority vote will form the government. So, they are the popular government chosen by people. They will be headed by prime minister and collectively they are responsible for law making or policy formulation. Prime minister and cabinet are the members of the parliament and they remain the members until they get support from majority. If the majority suffers they will have to dissolve, this is called as no-confidence motion by members. Majority of countries in the world are under Parliamentary system.
4.3 Nationalisation of Banks in India a comprehensive story

Different styles of government prevail in different countries. A country like India with huge population, diversity, its ethnicity, varied culture, multiple languages, and many religions has complex and multi-fold challenges. We are in the era of welfare state, where more importance is given to its citizens. As an activity and discipline, public policy has transformed into Policy Science. The success of economic development depends on countries powerful policies and its effective implementations. One such policy for India may be Economic Liberalisation, which drastically catapulted the economic condition. In the next coming chapters, we can see details of liberalisation actions of Indian government and its outcomes.

Nationalisation of banks during 1969 is one of the significant economic reform happened in India, with this nationalisation of 14 banks took place. Nationalisation is transforming private ownership of banks to public ownership under bring under government supervision. 14 banks which were operated on private ownership in India converted into public ownership by a resolution in parliament. Indira Gandhi was the prime minister during nationalisation, wrote new chapter for Indian banking history. Nationalisation of banks in India has taken in phases post-independence. There are many rationales to this decision, behind nationalisation. There were economic reasons, political reasons and pressure from international governance and reforms etc.

Commercial Banks till late 60’s was mainly focused on financing trade, commerce and industries. Social Banking or lending priority sectors was not given due importance and recognition. The socialistic objectives for India was popularised by leaders like Nehru and Subhash Chandra Bose, were the strong philosophies for any developmental activities. The government’s five-year plans, which were instruments for translating these socialistic objectives were graduated by each plan year with new agenda of the government. The plans were absolutely based on the principles of self-reliance. The socialistic approach of Nehru continued by his daughter, when she took charge of the country as prime minister. The timing of nationalisation in the wake of political and economic situation was perfect to implement the policy. The detailed study will show the...
multifold reasons for nationalisation of banking. There was political reason, economic reason and even the circumstances in Indian economy created by private banks prompted the government to go far nationalisation.

**Real reason for Nationalisation of banks:**

When India got independence, there were nearly 600 commercial banks were operating. There was dearth of credit facilities for priority sectors since all these banks were private. So, State Bank of India was formed out of imperial bank to facilitate the credit.

Even though after formation of SBI, there was lack of reach of banking facility in many sectors including agriculture. Since agriculture was main occupation and source of income at that time, the focus was very much necessary. The share of agriculture credit from total commercial banks was very minimal, stood at little more than 2%. But an ambitious project like HYVP (High Yield Variety Program) was not seeing the success as expected. Due to credit issues, farmers were deprived of utilising new technologies for HYVP. But SBI alone was not able to take this pressure, even RBI support to co-operative banks was limited. Situation has arised when there was huge shortage of food grains in the country.

Even after independence banks were continuing their priority of providing credit to industries as happened during colonial and British rule. Their focus was mainly on manufacturing industries, but they neglected small scale industries, cottage industries, internal trades and other economic activities. Trade was declining at 19% from 36%. The share rose periodically in large scale industries touching 68% in 1968 from 34% in 1951. This is double growth in a span of a decade. Even among this credit, the major share was with corporates getting benefit of 80% and above. These corporates include large industries and business houses run by families affiliated to British. Because of their ownership or proximity, they could claim easily on increasing proportion of the incremental bank credit and banks themselves were perfectly happy to fall in line. Majority of these corporate banks were owned by few large-scale industries. Evidence to
Directorships of 20 leading banks during 1963 shows that 188 persons who were on the board of these banks were also the directors for other companies. The profit margin and guarantee of credit was most favorable from these sectors. This focus on large scale industries was also due to the 5yr plan of the government, which was promoting its mixed economic policy.

The political issues surfaced in congress party and pressure from left parties. Inside congress there was old and experienced heads that was called as Syndicate, was continuously pressurizing Indira Gandhi to nationalize the banks. The point of contention among syndicate was that the private banks are not providing sufficient credit facilities across the country for needy people. Another committee under the leadership of Venkatappiah Committee-1969 named as All India Rural credit review committee endorsed the view that the Central Bank should increasingly come forward to finance activities in rural areas.

In that way, the socialistic objectives of congress government was taking a setback. This made the situation among political leaders very grim. But nationalisation was continuously opposed by Indira Gandhi and banking industry representatives. They even argued that social control over banks was also not necessary. They justified saying, Reserve Bank of India as an apex bank is a controlling authority on banks in terms of supervision, regulation, credit control and even it has a say in management affairs. The RBI was also authorized to appoint or to dismiss any of the chairman or the directors of any commercial banks and it can lay down the terms and conditions for its chief executives on their service obligations. It can inspect and audit banks thoroughly, and its approval was very much necessary for all advances more than Rs. 1 crore to any borrower. RBI also had task to regulate the opening of branches, formation of any mergers and direct all the aspects of credit policies of commercial banks.

Another feature of social control was establishment of a National Credit Council. The Finance Minister would be its Chairman, and the representatives are from agriculture, trade, industry, banks and any other professional groups. The RBI was given
additional powers, and the boards of directors of banks were reconstituted with a majority of composition from non-industrialists in its board.

The National Credit Council established in December 1967 to study and implement social objectives and to determine priorities of bank credit. This committee was led by Prof. Dhananjay Ramchandra Gadgil, who was a chairman of planning commission and founder of Gokhale Institute of Politics and Economics, Pune. He is famous for his Gadgil formula. The committee studied banking credit facility penetration to rural areas and found that commercial banks in India during June 1967 has negligible share of credit standing at only 1% out of 39% of institutional credit for agriculture. It revealed through its study that the commercial banks are not at all effective in rural areas and they were not useful in assisting the credit facilities for rural needy people.

In addition to these issues, nationalisation was a task with huge cost, at the backdrop of United Nations adoption of “Permanent Sovereignty over National Resources” in its 1803 resolution dated 14th December 1962. It was guiding to compensate to the owner appropriately when there is nationalisation. It means if there is nationalisation, the owner shall be paid compensation appropriately. Here appropriate compensation refers to countries which are developed and developing countries differently.

Therefore, government was not in favor for nationalisation which would involve huge payment of compensation to shareholders of banks. The social control was felt more appropriate rather actually owning these institutions. The stage was set with a party meeting which accepted for socialist control on banks with RBI as the governing entity on these private banks. Even banks accepted this proposition. By February 1969, government enacted Banking Laws Amendment Bill by making the social control scheme into an act. Then Deputy Prime Minister Morarji Desai introduced this bill in parliament and made statement on December 1968 by saying “to regulate our social and economic life so as to attain the optimum growth rate for our economy and to prevent at the same time monopolistic trend, concentration of economic power and misdirection of resources”. But there was still a huge protest to this amendment as the demand was to
nationalise. The justification from Finance Minister Morarji Desai and Prime Minister was very strong towards socialist controls. Though people were happy with social control, party leaders were not happy and continued their agitations. Addressing all India Congress Committee meeting at Faridabad in April 1989, Indira Gandhi shows her discomfort to nationalise banks. She was clearly justified her stand that she was not opposing for nationalisation, but to keep all the factors in concern before accepting, and even a fair chance was required to try social scheme. The fact was also that there was not enough manpower to support the banks that time.

But all-of a sudden to everyone’s surprise, in July Indira Gandhi supported the nationalisation of banks by submitting a note to the All-India Congress Committee meeting which was held in Bangalore. Her actual words on this subject were: “There is a great feeling in the country regarding the nationalisation of private commercial banks. We can consider the nationalisation of a few top banks or issue directions that the resources of banks should be reserved to a larger extent for public purposes.” She also suggested to private banks to invest in government securities upto 5%, which can makeup Rs.200 crores for the government, this amount can be utilized for social sectors for developmental schemes like minor irrigation, rural electrification, fisheries etc. She has taken evidence of few boards of directors and the former industrial chairman of few banks still continued on the boards and influenced the present chairmen who had previously been general managers. There was clear favorism for private banks, so she uttered nationalisation of banks as solution. This time it was absolutely dejected by Morarji Desai, in a written statement to Indira Gandhi in a note issued on July 10, he said: “Recent experience does not suggest that the large banks need to be taken over so as to be made to do something which they are not doing. There is no reason why, under social control, they cannot be made to do what the State Bank is doing if that is in the national interest. Nor is it right that the State Bank should be expected to do what banks, as institutions concerned with the safety of their depositors' funds, cannot do. Mere nationalisation will not provide more resources.” He put his viewpoints that banks are responsible for people money and they have all the rights to safe guard their client
money by deploying suitably. He stressed that no bank, whether in the private or the public sector, could abandon the test of viability of a credit transaction. Having thoughts of Gandhian principles, Desai was socially conservative, pro-business, and in favor of free enterprise reforms, as opposed to Prime Minister Jawaharlal Nehru's socialistic policies. But the remarks made by Morarji Desai was not taken in to consideration, rather on 29th July 1969 Indira Gandhi overtook the Finance Mister portfolio and announced the decision to nationalise 14 banks. These dramatic situations made a stage for an ugly cold war between Indira Gandhi and Morarji Desai. He continued showing his discomfort by resigning from cabinet and described Indira Gandhi move as clever move. He wrote to her separately mentioning, “If you wanted a change in the Finance Ministry, you could have discussed it with me. You know very well that I never discussed any matter with you in an improper manner. Even when I have differed from you on some matters, I have never been guilty of impropriety or discourtesy. But now you have behaved towards me in a manner in which no one would behave even with a clerk”\textsuperscript{17}. It was justified for Indira Gandhi to pluck Morarji Desai from her way out to implement her policies.

By this way in July 1969, the Government of India nationalized 14 private commercial banks whose national deposits were greater than Rs. 500 million, and resulting in the nationalization of 54 percent of branches with total 84 percent of government control on banking sector.

The two main objectives or goals of nationalisation were fulfilled through passing the bill. The goals such as rapid branch expansion and channeling of credit according to the plan priorities are made possible through nationalisation of banks.

As part of nationalisation, lead bank scheme also introduced in December 1969, same was implemented based on the recommendations of Gadgil Study Group.

As discussed earlier, The National Credit Council was set up in December 1967 under the leadership of Prof. D R Gadgil to determine the priorities of bank credit among various sectors of the economy. The National Credit Council also appointed a study group on the organizational framework for the implementation of social objectives in
October 1968. The study group found that the Commercial Banks in India had penetration of only to around 5000 villages as on June 1967. The institutional credit to agriculture was at 39%, making its share negligible at 1%. The balance of the coverage being met by the co-operatives banks.

The main objectives of lead banks were to;

- Eradication of unemployment and under employment
- Appreciable rise in the standard of living for the poorest of the poor
- Provision of some of the basic needs of the people who belong to poor sections of the society

As committee rightly pointed out, the agriculture, small scale industries and other allied industrial activities were neglected of credit facilities by these commercial activities. It recommended that commercial banks should increasingly fund towards rural financial activities. Under this lead bank scheme every district was assigned to a particular bank, it may be public or private to act as a consortium leader to overlook the efforts of all banks for expansion and credit planning.

One more unique scheme adopted by RBI in this period is village adoption scheme\textsuperscript{18}, where RBI encouraged banks to adopt villages for financial inclusion.

The pros and cons of these lead banks will be discussed in detail in forth coming chapters while analyzing the performance of banks.

4.4 Economic Liberalisation

The era of banking revolutions continued till 1991 when India has faced huge balance of payment crisis (BOP). By 80’s nationalised banks were handling more than 80% of economy of banking sector in India. Banking sector in India had huge load on financial burden and had immense responsibility towards development. Indian banking sector had severestructural problems, even though there was rapid growth rate in deposits. Banks were extremely unprofitable compare to international standards. There were many reasons for this ill performance of banks, but mainly the excessive control by government
on these banks has eroded the profitability. The concept of ‘Social Banking’ which is using Banking as an instrument for promoting socio-economic objectives, thereby converting ‘Class Banking’ to ‘Mass Banking’ made huge stress on its financial stability. Mass banking means expansion with more recruitment of staff, concessional interest lending made competition among banks impossible. Also India was facing huge financial crisis, where it airlifted its gold reserve to IMF to pay its debt. This act was widely criticized internally and externally. Gulf war also severed this crisis, as India was majorly depended on gulf countries for oil import. Financial sector reforms of a country were said to be an important agenda than social development.

The following table gives an indication of result due to banks performance since liberalisation.

**Table 4.1: Progress of banking sector since 1951 to 2015**

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<tbody>
<tr>
<td>1</td>
<td>No of Commercial Banks (Incl. RRBs)</td>
<td>566</td>
<td>89</td>
<td>279</td>
<td>276</td>
<td>293</td>
<td>289</td>
<td>251</td>
<td>208</td>
</tr>
<tr>
<td></td>
<td>a. Scheduled Banks</td>
<td>92</td>
<td>73</td>
<td>275</td>
<td>272</td>
<td>297</td>
<td>285</td>
<td>165</td>
<td>148</td>
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<td></td>
<td>b. Non-scheduled Banks</td>
<td>474</td>
<td>16</td>
<td>4</td>
<td>4</td>
<td>2</td>
<td>4</td>
<td>4</td>
<td>4</td>
</tr>
<tr>
<td>2</td>
<td>Number of Bank offices</td>
<td>4,151</td>
<td>8,262</td>
<td>53,840</td>
<td>60,220</td>
<td>67,339</td>
<td>70,324</td>
<td>88,203</td>
<td>125,672</td>
</tr>
<tr>
<td>3</td>
<td>Total Deposits of Scheduled Banks (Rs. in Billion)</td>
<td>9.08</td>
<td>46.46</td>
<td>1073.45</td>
<td>2011.99</td>
<td>851593</td>
<td>17001.99</td>
<td>44928.26</td>
<td>88989.01</td>
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<tr>
<td>4</td>
<td>Total Credit of Scheduled Banks (Rs. in Billion)</td>
<td>5.47</td>
<td>35.99</td>
<td>642.13</td>
<td>1218.65</td>
<td>4540.69</td>
<td>11004.28</td>
<td>32447.88</td>
<td>81188.41</td>
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*Source: RBI - Statistical Tables Relating to Banks in India*
By 1990 the banks were in a very bad condition with very low deposits, high credits and low networth. There was dearth need to correct this deficiency of banking sector. The liberalisation has put the sector to again in focus with bank branches expanding, deposit increasingly growing with increase in credit. Even NPA was growing, but the main focus or objectives were like opening wide network of branches across, development in rural areas, priority sector lending, higher employment generation, etc.

**4.5 Appointment of Narasimham Committee**

The then finance minister Manmohan Singh appointed a high-level committee under the leadership of former RBI Governor Shri M Narasimham. Manmohan Singh recalled the situation in his speech addressing at RBI Platinum Jubilee Celebrations in April 2010

“I was convinced that the economic liberalisation and reforms could only succeed if complemented by broad based reform in the banking and financial sectors. I turned to my old friend and former RBI Governor Shri M Narasimham to Chair a Committee to make recommendations on this very important issue. The Report of the Narasimham Committee outlined a comprehensive agenda of reform which served as a blue print of what we needed to do in subsequent years”. No doubt it is one of the path breaking, rational and effective banking regulation which India has ever seen.

Two committees under the chairmanship of Narasimham was appointed in 1991 and 1998. The first committee was appointed by Manmohan Singh and the second was appointed by P. Chidambaram as Finance Minister in December 1997.

The first committee of Narasimham was formed to study all basic aspects of Banking, which relates to the structure, organisation, functions and procedures of the financial systems and to recommend improvements in their efficiency and productivity. Overall the purpose was simple, India was jumping in to a global arena was required with great stability and structure to compete with global players. This committee was assigned to help Banking sector to equip with this challenges.
The first Committee - 1991

The first committee identified 4 major problems of commercial banks\(^2\). 

1. **Reduce SLR & CRR rates**: During that period the SLR ratio was kept at a high rate of 38.5%. Due to this higher rates, the profitability of banks was affected. The committee recommended to maintain high liquid assets by commercial banks in the form of cash or gold and government securities. 

   Similarly, even the Cash Reserve Ratio- (CRR) was as high as 15% during those period. Taking both these reserves, banks needed to maintain 53.5% of their total resources idle with the RBI, making it non-performing\(^2\). 

2. **Reduce lending to priority sector**: Since nationalization of banks, government was pushing banks for priority sector lending. According to the data, it received 15% of the total bank credit at the time of bank nationalization. Continuing the momentum, advances to the priority sector has increased from 15% to 33.3% in 1974 and further to 40% in 1980. This lending to agriculture and small-scale industries at a concessional rate of interest was known as the directed credit programme. The committee opinioned that these sectors all these years have matured and thus do not need such financial support. In government's point of view, these credit programme were successful, but actually it has affected commercial banks in a bad manner by worsening the loan quality which then resulted in a shift from the security oriented loan to purpose oriented. Banks were given a huge target of priority sector lending, etc. ultimately leading these loans made to profit erosion of banks. 

3. **Change in Interest Rate Structure**: The committee found that in India the interest rates are regulated and controlled majorly by government, its intervention made bank to funds at a cheap rate under the SLR. Committee felt that subsidized lending should be made to certain sectors, but no need for interest subsidy. Committee was in the opinion that these subsidies made banks handicapped in terms of its strength and expanding credit supply.
4. **Additional Suggestions**: Committee also suggested the interest rates should be determined by market forces. It also suggested to minimizing the slabs of interest rates.

**Recommendations of the First Committee**

The main recommendations of Narasimham Committee (1991) on the Financial (Banking) System are as follows;

(i) As per the findings, the SLR was high, it recommended for reduction in Statutory Liquidity Ratio (SLR) to 25% in a phased manner for over a period of about 5 years. This was aimed to give banks more funds which was necessary to carry out day-to-day business.

(ii) Reduce Cash Reserve Ratio (CRR) by RBI, which was kept at very high level currently.

(iii) The priority sector lending should be brought down to 10% from prevailing 40%. It also recommended to redefine priority sector.

(iv) Deregulation of interest rates based on emerging market conditions.

(v) Banks whose operations have been profitable is given permission to raise fresh capital from the public through the capital market.

(vi) Balance sheets of banks and financial institutions are made more transparent.

(vii) Set up of special tribunals to facilitate and help banks to recover their debt speedily.

(viii) Committee recommended for changes in the banking structure by national and International banking. Make 3 to 4 large banks with international character, 8 to 10 national banks with national character with branches across the country and local banks confined to specific locality of the country. Along with that, the rural banks limited to rural areas.

(ix) Internal audit and internal inspections to be given more prominence in the banks.
(x) The committee also strongly recommended the Government to not go for further nationalisation of banks. Welcome new private and foreign banks with liberal policies in licensing.

(xi) Only control of RBI on these banks, but not by any Banking Division or the Ministry of Finance. The role of external agencies to be minimized.

(xii) To facilitate more on bad and doubtful debts, and to subsequently follow up for the recovery of these dues, set up of a new financial institution called the Assets Reconstruction Fund (ARF) recommended. It will take banks considerable burden in recovery.

Second Committee on Banking Sector reforms - 1998

This committee again headed by Shri M Narasimham was formed by P. Chidambaram when he was Finance Minister in December 1997.

The first committee recommendations had already brought lot of traction in Banking sector in India. Thanks to Naramimham recommendations, which unleashed the potential of banking sector in India. The potential of the sector catapulted to a different level. This encouraged the government to try aim of further strengthening the financial institutions in India. The second committee now focused on peripheral issues of banking like, Autonomy in Banking, reforms required for RBI, strengthening banking sector policies, concentrate on NPA’s, Regulation of foreign banks, focus on CAR etc. The focus was gradually increased to strengthening the sector with increase in capability to compete against foreign banks. Few recommendations of Narasimham on this regard has brought some positive changed required for the industry.

Recommendations of the Second Committee - 1998

By 1998 the committee has few more recommendations to reforms;

Since the focus was clear for the committee, they made direct recommendations on;
a. **Autonomy in Banking**

Committee recommended for greater autonomy for public sector banks. Entry of foreign banks in India made the competition in sector intense. Committee recommended for improved recruitment polices, selection of right candidates for banks, people development through skill training at par with market standards. It also recommended for decreased shareholding of government of India through its stake lesser to 33% on nationalized banks. The other observations of the committee were on composition of board of directors in nationalized banks, where it was always dominated by politicians and bureaucrats. It recommended for reduced or nil interference from these people on day-to-day matters of the bank.

b. **RBI Reforms**

The committee recommended for many reforms to be implemented by RBI, such as;

- **Recommended to introduce Liquidity Adjustment Facility (LAF),** which has to help banks adjust its day-to-day mismatches in liquidity. LAF consists of Repo and reverse repo rates, which helped adjust its SLR/CRR requirements whenever there is an emergency.

Tangential to the committee recommendation, the ownership on many banks has been transferred from RBI with its share value in its banks of SBI, NHB and NABARD to government of India. It is an integrated system of regulation recommended.

c. **Stronger Banking System**

As recommended under first committee, the emphasis was again made on stability of banking in India through the establishment of 3 large banks having international presence, 8 to 10 national banks and many regional and local bank. This proposal was severely criticized by the RBI employee’s union.

The recommendations also included merger and consolidation of banks for greater stability.
d. NPA’s (Non-Performing Assets)

Taking reference from its first committee recommendations, the main reason for loss in profitability was again highlighted through NPA’s. The Committee also recommended for the creation of Asset Reconstruction Funds or the organisations called as Asset Reconstruction Companies to take over the bad debts of banks, allowing them to start clean from beginning.

The committee also in its recommendations opted to allow foreign banks to allow its business in India with JV at par with private banks in India.

Likewise, Narasimham committee played an important role in shaping banking sector in India. The changes onset to these recommendations have further strengthen the industry which has high regard to its operations now. The global financial crisis of 2008 has not affected Indian economic system, due to better insulation from its banking industry.

4.6 Other important Committees on Banking Sector

List of some important Committees Related to Banking & Finance in India

Few important committees which changed the entire banking structure and operations in India are:

- A C Shah Committee – Functioning of NBFC
- A Ghosh Committee – Related to Final Accounts
- A Ghosh Committee – On Modalities of Implementation of New 20 Point Programme
- A Ghosh Committee – Study on Frauds & Malpractices in Banks
- Abid Hussain Committee – Development of Capital Markets
- Adhyarjuna Committee – Study on Changes in Negotiable Instrument Act and Stamp Act
- AK Bhuchar Committee – Study Coordination Between Term Lending Institutions and Commercial Banks.
- B Eradi Committee – Insolvency and Wind Up Laws
B Sivaraman Committee - Institutional Credit for Agricultural & Rural Development

B Venkatappaiah Committee - All India Rural Credit Review

BD Shah Committee - Stock Lending Scheme

BD Thakar Committee - Job Criteria in Bank Loans (Approach)

Bhagwati Committee - Public Welfare Unemployment

Bhave Committee - Share Transfer Reforms

Bhide Committee - Coordination Between Commercial Banks and SFC’s

Bhootlingam Committee - Wage, Income & Prices.

C Rao Committee - Agricultural Policy

CE Kamath Committee - Multi Agency Approach in Agricultural Finance

Chatalier Committee – To study on Finance to Small Scale Industry

Chesi Committee – Recommendations to Direct Taxes

Cook committee (On Behalf of BIS – Under Basel Committee) - Related to Capital Adequacy of Banks.

D R Mehta Committee - Review the Progress and Recommend Improvement Measures of IRDP

Damle Committee - Related to check feasibility of introducing MICR and OCR

Dandekar Committee – On study of Regional Imbalances

Dantwala Committee - Estimation of Employments

Dave Committee - Related to Mutual Funds functioning

Dharia Committee – To Study on Public Distribution System

DR Gadgil Committee – Study on Agricultural Finance

Dutta Committee - Related to Industrial Licensing.

G Lakshmai Narayan Committee - Extension of Credit Limits on Basis Of Consortium

G Sundaram Committee – Study on Export Credit

Gadgil Committee (1969) – Recommendations on Lead Banking System

Godwala Committee – Advice on Rural Finance

Goiporia Committee - Customer Service in Banks
GS Dahotre Committee - Credit Requirements of Leasing Industry

GS Patel Committee - Carry Forward System on Stock Exchanges.

Hathi Committee - Soiled Bank Notes

Hazari Committee (1967) - Industrial Policy.

IT Vaz Committee - Working Capital Finance In Banks.

J Reddy Committee - Reforms In Insurance Sector

James Raj Committee - Functioning Of Public Sector Banks


JV Shetty Committee - Consortium Advances.

K Madhav Das Committee – Study On Urban Cooperative Banks

Kalyansundaram Committee - Introduction Of Factoring Services In India

Kamath Committee - Education Loan Scheme

Karve Committee - On Small Scale Industry

KB Chore Committee - Related to: To Review The Symbol Of Cash Credit

Khanna Committee—Non-Performing Assets

Khusrau Committee - Agricultural Credit

KS Krishnaswamy Committee - Role Of Banks In Priority Sector And 20 Point Economic Programme.

KS Shere Committee - Electronic Fund Transfer

L K Jha Committee - Indirect Taxes

LC Gupta Committee - Financial Derivatives.

Mahadevan Committee - Single Window System

Mahalanobis Committee - Income Distribution

Marathe Committee - Licensing Of New Banks

ML Dantwala Committee - Regional Rural Banks

Nadkarni Committee - Improved Procedures For Transactions In PSU Bonds And Units

Nariman Committee - Branch Expansion Programme
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- **RG Saraiya Committee (1972)** - Banking Commission
- **RH Khan Committee** - Harmonization Of the role of Financial Institution in Banks
- **RK Hajare Committee** - Differential Interest Rates Scheme
- **RK Talwar Committee** - Enactment Having A Bearing On Agro Landings By Commercial Banks
- **RNMalhotra Committee** - Reforms In Insurance Sector
- **RN Mirdha Committee** - Cooperative Societies
- **RV Gupta Committee** - Agricultural Credit Delivery.
- **S Padmanabhan Committee** - Onsite Supervision Function Of Banks
- **S Padmanabhan Committee** - Inspection Of Banks (By RBI)
- **Samal Committee** - Rural Credit
- **SC Choksi Committee** - On Direct Tax Law
- **Shankar LalGauri Committee** – Advice on Agricultural Marketing
- **Shivaraman Committee** - Institutional credit for agriculture and rural development
- **SK Kalia Committee** – Study on Role Of NGO And SHG In Credit
- **SL Kapoor Committee** - Institutional Credit To SSI
- **Sodhani Committee** - Foreign Exchange Markets In NRI Investment In India
- **SS Kohli Committee** - Rehabilitation Of Sick Industrial Units
- **SS Kohli Committee** - Rationalization Of Staff Strength In Banks
- **SS Kohli Committee** - Willful Defaulters
- **SS Nadkarni Committee** - Trading In Public Sector Banks
- **SS Tarapore Committee** - Capital Account Convertibility
- **Sukhmoy Chakravarty Committee** - To Review The Working Of Monetary System.
- **Tambe Committee** – Recommendations on Term Loans To SSI
- **Tandon Committee** - Follow Up Of Bank Credit & Export Policy
- **Thakkar Committee** - Credit Schemes To Self Employed
- **Thingalaya Committee** - Restructuring Of RRB
Tiwari Committee - Rehabilitation Of Sick Industrial Undertakings.

UK Sharma Committee - Lead Bank Scheme (Review)

Usha Thorat Panel - Financial Inclusion.

Vaghul Committee - Money Market, Mutual Fund Schemes

Varshney Committee - Revised Methods For Loans (>2 Lakhs)

Venketaiya Committee - Review Of Rural Financing System

Vipin Malik Committee - Consolidated Accounting By Banks

VT Dehejia Committee - To Study Credit Needs Of Industry And Trade Likely To Be Inflated

Vyas Committee - Rural Credit.

Wanchoo Committee - Direct Taxes

WS Saraf Committee - Technology Issues In Banking Industry.

Y H Malegam Committee - Disclosure Norms For Public Issues

YV Reddy Committee - Reforms In Small Savings
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