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View: Modi government will never privatise India's sinking public sector banks

BY [SWAMINATHAN A AIYAR](#), TOI CONTRIBUTOR | JUL 23, 2017, 11.04 AM IST

Post a Comment

Having established a reputation as an incrementalist who shuns radical change, Prime Minister [Narendra Modi](#) has suddenly changed expectations by opting to privatise Air India. This is such a huge public sector giant with so many subsidiaries and lakhs of employees that nobody ever dreamed it could come first in the list of Modi [privatisations](#). Yet that is the case.

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Some Americans have asked me whether this might be followed up by the privatisation of [public sector banks](#) (PSBs). These too are big in financial size and employment, and some are in almost as bad shape as Air India. If Modi can sell Air India, why not the PSBs?

It won't happen. Public sector banks have always been used by successive governments to implement schemes for which there is insufficient money in the budget. We are now in an era of fiscal stringency, with the Fiscal Responsibility and Budget Management Act obliging the government to keep cutting its fiscal deficit. In these circumstances, there is less fiscal space than ever for launching new government schemes.

So, public sector banks provide an especially important means for the finance minister to finance schemes that can fetch votes and possibly improve economic outcomes. This is equally true of public sector insurance companies, and oil companies (which for years subsidised diesel and petrol). These will, therefore, not be privatised.

Two years ago, when finance minister [Arun Jaitley](#) was visiting the US, he asked what journalists like me meant when we asked for big-bang reforms. For starters, I said, privatise the ten worst public sector banks. He laughed and said this was difficult because the banks played such an important role in the implementation of government policies.

For instance, he said, infrastructure was a top priority, but private banks were not very keen on lending to that sector, and so PSBs had proved invaluable in providing finance for infrastructure.



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What he did not say was that private banks had proved very prudent in steering clear of infrastructure projects of dubious viability that carried many risks. When dozens of infrastructure projects sank, for a variety of reasons, the PSBs were left with bad loans totalling lakhs of crores.

Critics like me might say that this is precisely why the banks should be privatised — they will show greater diligence before approving projects with unclear financial profiles. But from the politician's viewpoint, forcing PSBs to lend for infrastructure was an essential way of achieving targets without breaking budgetary limits set by law.

Education loans provide another example. The government is keen on expanding such loans to students, who are increasingly entering high-cost private colleges. So, public sector banks have been instructed to step up education loans.

A recent news item said outstanding education loans had risen from Rs 48,382 crore in March 2013 to Rs 72,336 crore in December 2016, a pretty fast rate of expansion. But non-performing loans — those on which borrowers had defaulted in payment for over 90 days

— had shot up in the same period from Rs 2,615 crore to Rs 6,336 crore. The ratio of non-performing to total education loans has risen from 5.40% to 8.76%, a sad tale of sinking viability.

Private sector banks are aware of the high risks in such loans and have mostly steered clear of them. No less than 90% of all educational loans have been given by public sector banks. In some countries, the risk is transferred to the government. In India, PSBs have been loaded with the risk.

A similar tale comes from public sector insurance companies, which have been obliged to launch schemes at unviable low premiums. The government has created a Pradhan Mantri Jeevan Jyoti Bima Yojana — a term life insurance policy.

In 2016-17, the second year of its operation, claims under this scheme exceeded premiums by 21%, making it unsustainable. An even worse outcome afflicted the Pradhan Mantri Suraksha Bima Yojana, which provides payment of Rs 2 lakh for accidental deaths or grievous injuries. In this case, claims were a whopping 70% higher than premiums. By contrast, private insurance companies with similar insurance policies have a claims rate less than half the premiums.

Politicians are reluctant to raise the ultra-low premiums for flagship schemes aimed at capturing votes. No such instructions on premiums can be given to private insurance companies. That's a key reason why the government insurance companies, like government banks, will not be privatised. They are too politically valuable for governments seeking to distribute freebies and subsidies.

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