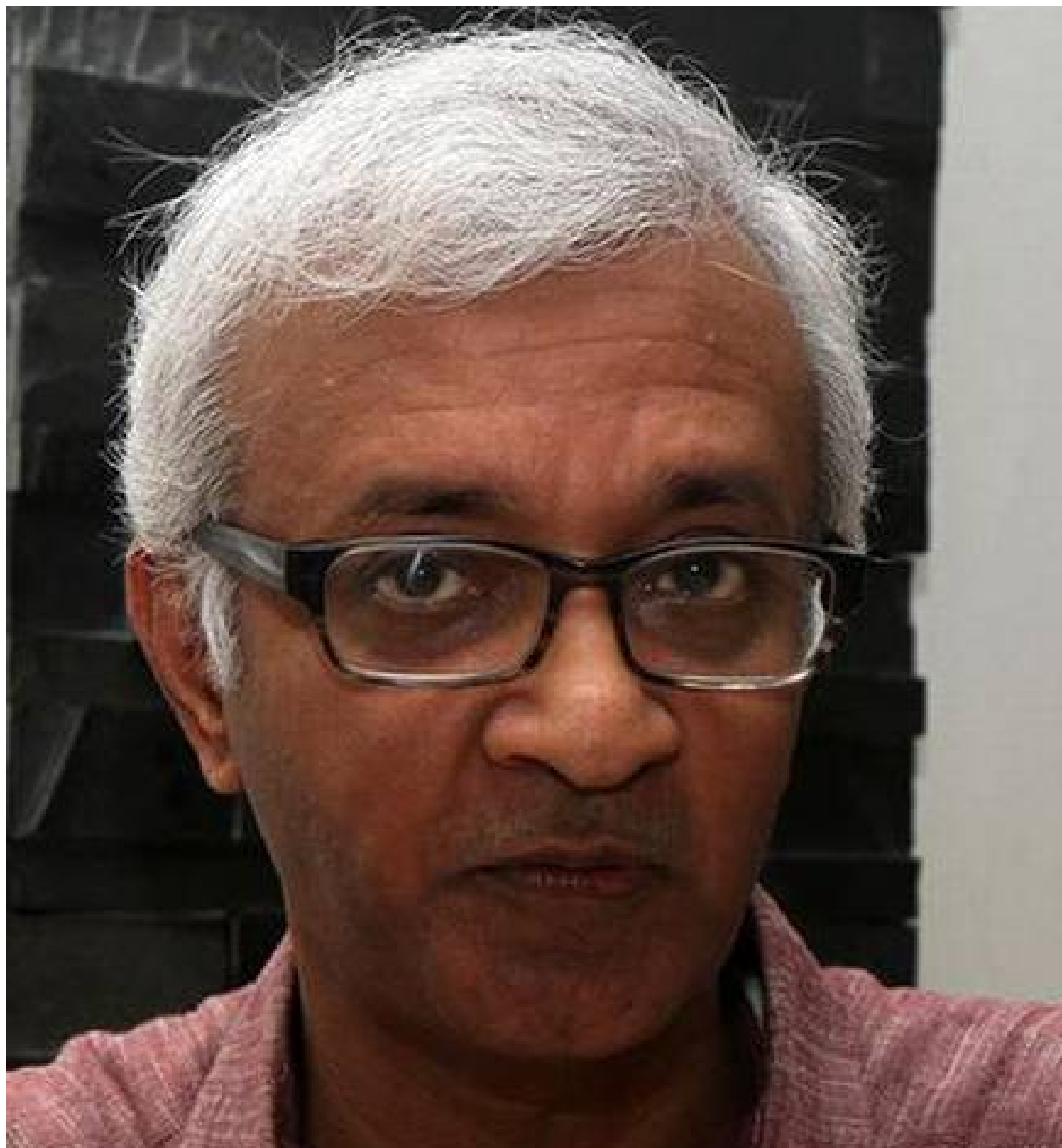


‘Privatisation of banking system ideal for the modern economy’

N RAMAKRISHNAN





Rangarajan Sundaram feels that even private banks must be regulated - N Ramakrishnan

No need for so many nationalised banks, says Rangarajan Sundaram, Dean, NYU's Stern School of Business

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The existence of nationalised banks is antithetical to modern India, says Rangarajan Sundaram, Dean, NYU's Stern School of Business.

There is no political will to privatise the banks and there is no other reason to have so many nationalised banks, he said, during a recent interview in Chennai, when he was asked about the financial fraud at the government-owned Punjab National Bank.

“Ask yourself that question, if you were devising a banking system *Ab ovo*, would you have so many nationalised banks in the country. The answer is clearly not. Therefore, we have a sub-optimal banking system,” he said.

What would an ideal banking system for today's India look like, he wondered, and said, “my suspicion is we would find very few nationalised banks in an ideal system”. It was like having nationalised car companies.

Market forces, said Sundaram, do not impinge on nationalised banks the way they do to a HDFC Bank or an ICICI Bank. It was time to bring market discipline to play. Nationalised banks had this unfortunate feature in that everybody thinks the government would back-stop them since it owned them.

Regulatory problems

However, he said, privatisation was not a panacea to getting rid of the regulatory problem. Even private banks needed to be regulated because banks controlled the payment system, which was vital to the operation of the economy.

Banking crises, he said, erupt in countries where banks are largely private also. It had happened in the US, the UK and Europe. SocGen, JP Morgan and UBS were some that had faced major problems. Risk management and regulation, Sundaram said, were important to all banks. Regulators could never afford to take their eye off the ball and privatisation was not a panacea to either the risk management issue or the regulatory issue.

Privatisation, however, would make the banking system more responsive to the needs of a modern economy. “We have an economy that is modernising at breakneck speed in some areas, and in some areas we are stuck with a legacy which is really out of tune with a modern India,” said Sundaram, an Economics graduate from the University of Madras and an MBA from IIM Ahmedabad before obtaining an MA and an PhD in Economics from Cornell University.

It was a “classic statist argument for why you need state control on everything” to say that private banks had faced huge scandals in the West and that India could ill afford to have such things happening here. For many years, Sundaram argued, Myanmar ran a closed economy in which it had no banking crisis, no crisis of any sort, no trade. Only problem was they had no growth.

“So, it is all right to look at the downside and say, we avoided the downside. What about the upside,” he asked. “What about the fact that Korea and China were growing at 10 per cent, and we were limping along at 5 per cent a year because the banking system was too sclerotic to respond to the needs of the economy,” he said.

Risks and benefits

There were risks and benefits in privatisation. “To me, the benefits clearly outweigh the risks because markets are really very sensitive,” he said. Anything that was chugging along in India was strongly driven by the private sector. “Our tech companies are not state-run organisations. The only bank of ours that ranks in the top 50 companies in Asia is HDFC Bank, which is a private bank.”

He pointed out that HDFC, ICICI, IDBI and IFCI were all development finance institutions and two of them – ICICI and HDFC – got privatised while the others did not. “Look at the difference today. Look at the growth that has been enabled by ICICI and HDFC/HDFC Bank.”

“I find this argument really sad when you say I want to avoid downside risks, so I am not going to do anything. We have hundreds of millions of people in poverty who need to be lifted out of poverty. You can’t do that unless you free up the system,” added Sundaram.