SPECIAL REPORT

Banking Sector Liberalization in India: Some Disturbing Trends

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In the first week of August 2005, Reserve Bank of India (RBI), country's central bank, issued a list of 391 under-banked districts in India with population per branch more than the national average of 16,000. The list was part of a policy directive issued by the central bank to all commercial banks asking them to work out their branch expansion strategies "keeping in mind the developmental needs of unbanked regions." The directive called for greater emphasis to be given to under-banked regions while seeking licenses for bank branches.

The policy directive (including the list of under-banked districts) was posted at the RBI's website. However, the document was removed from its website the very next day. No explanations were given by the central bank on why the document was removed from the website. Apparently, the document was removed at the behest of Finance Ministry's pressure as it expected to fuel a strong public reaction that may imperil the ongoing move towards greater banking sector liberalization. This speaks volumes about the present-day discourse on transparency and accountability in economic policy-making.

If 391 districts out of a total 602 districts in India are under-banked, it raises several policy issues which cannot be suppressed by keeping public in dark about the ground realities of the banking sector. On the contrary, such an anomaly could only be addressed through wider public consultation and debate.

According to the RBI's list, states such as Uttar Pradesh, Madhya Pradesh and Bihar have the maximum number of under-banked districts in the country (see Table 1) while states and union territories such as Goa and Chandigarh do not have any under-banked districts. Interestingly, some of the under-banked districts also include prominent industrial cities such as Surat in Gujarat.

Table 1: Number of Under-banked Districts in India

Andhra Pradesh	13	Karnataka	7	Orissa	22
Arunachal Pradesh	11	Kerala	1	Pondicherry	1
Assam	22	Madhya Pradesh	43	Punjab	1
Bihar	37	Maharashtra	26	Rajasthan	25
Chhattisgarh	15	Manipur	8	Sikkim	1
Gujarat	12	Meghalaya	3	Tamil Nadu	14
Jammu & Kashmir	4	Mizoram	2	Uttar Pradesh	63
Jharkhand	18	Nagaland	11	West Bengal	16

No one can deny the fact that rapid increase in bank branches took place in the post-1969 period when India nationalized its banking sector. There were several objectives behind the bank nationalization strategy including the transformation of class banking into mass banking and to reach out to neglected sectors such as agriculture and small scale industries.

At the time of nationalization, there were only 89 scheduled commercial banks with 8262 branches throughout the country. But in March 2004, the number of scheduled commercial banks increased to 290 and the branch network increased to 69071. With such a rapid increase in bank branches, the population covered per branch, which was 64000 in 1969, also decreased to 16000 in 2004.

Even the proponents of banking sector liberalization admit that such a rapid expansion of bank branches, with more than half of the branches opened in rural areas, after nationalization was unparalleled in the recent economic history of any other developing country.

No doubt, the banking system under the nationalization regime was not perfect as it failed to meet the banking needs of remote rural areas and small borrowers but at least a serious effort was made to spread banking services both geographically and functionally. No one can deny that there was corruption, lack of transparency and bureaucratic control which affected the functional efficiency of the banking system. But despite all these operational and other problems, the positive thing about that regime was that the entire banking system was subservient to the needs of the real economy; which is certainly not the case in the post-liberalization period.

In the post-liberalization period, one finds that the rural bank branches are being closed down (from 32939 in March 1997 to 32227 in 2004) in order to meet the profitability criteria, while there has been a rapid growth in the bank branches in the urban, metropolitan areas (from 8390 in March 1997 to 9750 in 2004).

However, there are several regional disparities. For instance, Uttar Pradesh, Bihar and the entire North-eastern region witnessed a decline in the number of branches in the post-liberalization period. Whereas states such as Delhi, Haryana, Punjab and Maharashtra have witnessed a steep hike in the bank branches. Delhi, for instance, witnessed a jump of more than 30 per cent in bank branches, from 1256 branches in 1997 to 1639 in 2004.

More importantly, the banking sector under the post-liberalization period is witnessing a secular decline in rural credit. The rural credit went down from 15.7 per cent in 1992 to 11.8 per cent in 2002 (see Table 2).

Table 2: Decline in Rural Credit

Year	**Percentage of Rural Credit to Total Credit**
1992	15.7
1993	14.8
1994	14.7
1995	12.8
1996	12.3
1997	12.3

1998	12.3
1999	11.9
2000	11.5
2001	11.0
2002	11.8

According to a recent study by the Associated Chambers of Commerce and Industry of India (Assocham), an influential business lobby group, the regular fall in rural credit in the last decade led to an adverse development in the agricultural sector, and also increased the apathy of institutionalized finance for the farming community.

While putting the onus on the banking sector liberalization program on the poor performance of agricultural sector, the Assocham study pointed out that while the banking sector garnered deposits exceeding Rs. 1000000 million from the farming community in the last decade, the credit extended to them did not even touch Rs. 500000 million.

The study also noted that out of 27 state-owned banks and as many banks in the private sector, only five public sector banking institutions and two from the private sector met the required 18 per cent agricultural credit extension target to the farming community between 1992 and 2002. Further the study found that creditallocation towards metropolitan region increased from 44.84 per cent in 1990-91 to 61 per cent by the end of 2003-04, thereby revealing a clear urban bias in the credit allocation.

Given the fact that the bias towards urban areas is expected to grow as Indian credit markets are driven by consumer loans and just 20 cities contribute over three-fourths of new assets creation, this anomaly needs to be addressed by policy makers.

In this context, it is also important to highlight that much-touted microcredit programs launched by self-helf groups and NGOs are no substitute for the bank lending provided by commercial and regional rural banks in India. At best, microcredit programs can complement, not substitute, the growing credit needs of farmers, rural entrepreneurs, small enterprises and informal sectors of economy.

In the post-liberalization period, one also finds that the lending to small and medium enterprises (SMEs) has declined from 15 per cent in 1991 to 11 per cent in 2003. SMEs are the engines of India's economic growth, together they contribute 40 per cent of India's total production, 34 per cent of exports and are the second largest employer after agriculture. The growing neglect of bank lending to SMEs can have adverse implications on economic growth and employment.

At the consumer level too, small borrowers and depositors are facing the burnt of liberalization policies. Banks are charging higher fees from customers and it is becoming more expensive to maintain a bank account.

In the light of these developments, it remains to be seen whether commercial banks would follow the RBI's directive of providing banking services to unbanked regions or pursue their narrow commercial interests. As the recent experience shows, it is highly unlikely that the commercial interests of banks would match with the developmental needs of unbanked regions of the country. Rather than expecting banks to voluntarily open branches in rural and remote regions, the RBI should issue strict guidelines to ensure that banking services are made accessible to unbanked regions and people at large.