

Recapitalisation & Financial Sector Reforms

What is the issue?

\n\n

Recapitalisation of banks needs to be done with a clear and structured foresight.

\n\n

What is recapitalisation?

\n\n

\n

- Re-capitalisation of banks means infusing money into the banks in order to give them the liquidity needed to carry out lending and other banking functions.

\n

- On that note, it is a positive sign that the RBI, as the sector's regulator, and the government, as the principal shareholder of these banks, are in consultations on the problem.

\n

- Discussions on the question of time-bound capitalisation of the banks are needed.

\n

\n\n

Why did the liquidity crunch arise?

\n\n

\n

- The banking sector has recently taken a hit due to the build up of gross Non-Performing Assets (NPAs) which led to liquidity crunch.

\n

- NPAs stood at almost a tenth of the total bank loans at the end of the last financial year.

\n

- It has also been observed that NPAs are concentrated in Public Sector Banks.

\n

- Some PSBs have NPAs in the range of 15 to 24 per cent.

\n

- This has resulted in slowdown in bank's lending to industry, thus holding back private investment in economic growth.
\n
- The prevalence of bad loans also presents a serious systemic risk to the financial system.
\n

\n\n

What are the priorities in this regard?

\n\n

- \n
- **NPA Problem** -Settling the existing bad loans might require banks to write off a considerable sum, which would affect their capital provisioning, thereby requiring re-capitalisation.
\n
- But, given that NPAs are over Rs 6 lakh crores, a straightforward recapitalisation of PSBs would greatly strain the government's fiscal position.
\n
- Furthermore, in the absence of deep governance reform, it is far from certain that the problem of NPAs will not recur.
\n
- It is essential, therefore, that the structure of any bank bailout be such that future bad behaviour is not incentivised.
\n
- **Disinvestment** - Besides capital infusion by the government, raising capital from the market by dilution of government equity and sales of non-core assets are also being considered.
\n
- Dilution of government equity must be accompanied by a reduction in effective government control to make it an attractive buy for the private sector.
\n
- **Incentive Mechanism** -A mechanism to hold poor performer banks accountable and incentivising good ones is needed.
\n
- Such an approach will produce a stronger public sector banking system.
\n
- Certainly, India cannot afford to throw good money to address the problems of bad money.
\n

\n\n

\n\n

Source: Business Standard

\n

