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CAPITAL IDEA? ON BANKS RECAPITALISATION PLAN

Relevant for: Indian Economy | Topic: Issues relating to Growth & Development - Banking, NPAs and RBI

With just months to go for the general election, the government looks all set to open the credit taps of the economy. The Centre has sought Parliament's approval to infuse an additional 41,000 crore into public sector banks that are starved of precious capital to remain afloat. Along with another 42,000 crore that is already budgeted for infusion, this tranche will take the total planned funds infusion into banks this year to 83,000 crore. More important, the infusion will help banks boost lending and stimulate economic activity going into an election year. In fact, the latest fund infusion is aimed, among other things, to help a number of public sector banks to climb out of the Reserve Bank of India's Prompt Corrective Action (PCA) framework. As many as 11 public sector banks have been stopped from lending freely by the RBI under the PCA framework due to their poor financial health. It is important that the additional capital is not wasted on banks that have not shown any improvement but rather used to support the weak ones that are on the recovery path. The government has said that PCA banks which have shown better performance in terms of reduction in NPAs and improvement in return of assets will be given priority. The proof will come when the allocations to individual banks are announced.

There have been reports that four banks under the PCA — Allahabad Bank, Bank of India, Corporation Bank and Bank of Maharashtra — will soon be out of the restrictive framework. This is following a review by the Board for Financial Supervision of the RBI, which went over the financials of all the banks under the framework. While Corporation Bank and Bank of Maharashtra have shown a semblance of improvement in their asset quality and registered a profit in the September quarter, the other two are not over the hump yet. The government is obviously keen to free up the banks from restrictions on lending. But it flies counter to the RBI's basic objective in keeping these banks under the PCA framework, which is to nurse them back to good health. In its eagerness to achieve its political objectives, the government should not end up pushing good money after bad by apportioning extra capital to these weak banks instead of supporting the ones that are on the recovery path. There are enough headaches for banks to handle in the form of the waiver of agriculture loans and the rising share of loans to small businesses, which are risky. While the idea of infusing more money into banks is not bad *per se*, given that they are grappling with inadequate capital, a lot depends on how and to which banks this money is distributed. This is where the government has to exercise prudence and caution.

The Congress must strengthen its democratic processes while choosing CMs

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