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Recapitalisation & Financial Sector Reforms

What is the issue?

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

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What is recapitalisation?

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- 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.
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- 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.
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- Discussions on the question of time-bound capitalisation of the banks are needed.
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Why did the liquidity crunch arise?

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- The banking sector has recently taken a hit due to the build up of gross Non-Performing Assets (NPAs) which led to liquidity crunch.
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- NPAs stood at almost a tenth of the total bank loans at the end of the last financial year.
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- It has also been observed that NPAs are concentrated in Public Sector Banks.
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- Some PSBs have NPAs in the range of 15 to 24 per cent.
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- This has resulted in slowdown in bank's lending to industry, thus holding back private investment in economic growth.
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- The prevalence of bad loans also presents a serious systemic risk to the financial system.
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What are the priorities in this regard?

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- **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.
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- But, given that NPAs are over Rs 6 lakh crores, a straightforward recapitalisation of PSBs would greatly strain the government's fiscal position.
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- Furthermore, in the absence of deep governance reform, it is far from certain that the problem of NPAs will not recur.
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- It is essential, therefore, that the structure of any bank bailout be such that future bad behaviour is not incentivised.
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- **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.
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- Dilution of government equity must be accompanied by a reduction in effective government control to make it an attractive buy for the private sector.
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- **Incentive Mechanism -**A mechanism to hold poor performer banks accountable and incentivising good ones is needed.
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- Such an approach will produce a stronger public sector banking system.
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- Certainly, India cannot afford to throw good money to address the problems

of bad money.

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Source: Business Standard

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