



Impact of banking sector reforms on Indian economy

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Abstract

The banking sector is an important part of Indian economy. The smooth functioning of the Indian economy is monitored and governed by it. Banking sector reform refers to changes implemented by regulatory authority and government in banking sector for enhancing the efficiency, stability, transparency and competitiveness of the banking sector. These reforms also aim to boost the effectiveness and output of the banking sector in India. These reforms are geared towards establishing a banking sector that is stable and capable of fostering the economic growth while ensuring the safety of depositors' interests, investors interests and overall financial system. The nature and scope of banking sector reforms may differ from one country to another, depending on their distinct economic and regulatory conditions. The present paper studies the impact of banking sector reforms on Indian Economy.

Keywords: Digital Rupee, GST, NPA, Foreign Investment etc.

Introduction

Banking sector reforms are vital in reshaping the banking industry in India and bringing it in the line with international standards. Banking sector reform refers to changes implemented by regulatory authority and government in banking sector for enhancing the efficiency, stability, transparency and competitiveness of the banking sector. The banking reforms comprise of many measures *viz.* privatization, deregulation, liberalization and technological advancements. The implementation of reforms such as recommendations of Narsimham Committee during the 1990s paved the path for strengthened the capital adequacy, risk-based supervision and the development of assets reconstruction companies. The adoption of Basel Norms additionally strengthened the robustness and risk management procedures of banking system (Uppal, 2011)^[11].

The adoption of technology-based initiatives *viz.* electronically transfers of funds, core banking solution and system of digital payment facilitated greater financial accessibility and boosted the efficiency of operations. Many initiatives like insolvency and bankruptcy code and Pradhan Mantri Jan Dhan Yojna played a substantial impact on increasing access to the various financial services and resolving the problem of non-performing assets. These changes have nurtured a banking sector which is more transparent, competitive customer-oriented. These changes has also contributed in the financial stability and economic growth of India (Tiwari, 2005)^[10].

Objectives

- To study the various reforms regarding banking sector in India.
- To study the impact of banking sectors reforms on Indian economy.

Research Methodology

Descriptive research design has been used in this study. Secondary data was collected to achieve the objectives of

the study. Various reputed journals, books and websites are considered while collecting the secondary data.

History of Banking Sector in India

The modern banking took place in India towards the end of 18th century. There were three banks such as Bank of Bengal, Bank of Bombay and Bank of Madras performed their functions effectively in India. A new bank Imperial bank of India was introduced with the merger of these three banks. The name of this bank has renamed as State Bank of India in 1955. The Reserve Bank of India came into force in 1935. After introduction, the work of monitoring and regulating the all banks of India is performing by RBI. A lot of changes have been made in the functions of commercial banks after the introduction Banking Regulation Act, 1949. Although the role of regulating the banking sector was playing by RBI, most of the banks were private sector banks except SBI. Till 1960, a substantial contribution was made by banking sector in Indian economy. In 1964, Nationalization of Banks Act was enacted. In 1969, 14 prominent commercial banks were nationalized and 6 banks were nationalized in 1980 and this process took place with the approval of president of India.

In 1991, P. V. Narasimha Rao initiated the policy of Liberalisation, Privatisation, and Globalisation. This resulted in the inclusion of international banks in India. The foreign direct investment also opened additional prospects. This led to easing of numerous prior government policies. The licensing, taxation, incorporation procedure and so forth became more adaptable for banking companies. In the 1990s, the Government of India established a high-level committee to enhance the functioning of financial institutions in India. They enacted various acts and implemented reforms for strengthen the banking system. India has witnessed various equivalent committees. The Banking System of India has important acts and reforms from two phases. The initial phase revolves around the fundamental policy and institutional frameworks. The second phase is characterized by the structuring and

advancement of the industry. The two committees that shaped the banking system of India are:

1. The Narasimham Committee 1991 - First Phase

The Narasimham Committee was the first committee in India which suggested the reforms for better and effective banking system in India. This committee was headed by Mr. Narasimham. The establishment of this committee was taken place after the economic crisis. This committee suggested many reforms like autonomy in banking system, changes in the role of RBI, debts recovery, Change in Monetary policy, operational freedom, entry of foreign banks, prudential norms and local area bank.

2. The second Narasimham Committee 1998 - Second Phase

This committee was also chaired by Mr. Narasimham. He was the 13th governor of RBI. This committee was the extended form of first committee. The reforms were overviewed by this committee which were formulated by the first committee. Many suggestions have been made by this committee such as financial institutions development, making more strong banking system, NPA, Capital adequacy and rural and small industrial credits.

Banking Acts

RBI Act, 1934: The Reserve Bank of India was established as a central bank of India with the help of this act. The functions and objectives of the RBI *viz.* regulating monetary policy, managing and issuing currency notes and managing foreign exchange reserve were defined by this act. This act also grants the various powers to RBI such as to issue guidelines and direction to all commercial banks and financial institutions.

Banking Regulation Act, 1949: This act is an important law that governs and oversees the banking system in India. It authorizes the RBI to monitor banks and their activities. The act outlines the authorities and responsibilities of the RBI, banks licensing, capital prerequisites and regulations regarding the governance and management of banks. The institution named Deposit Insurance and Credit Guarantee Corporation was established by this act for insuring the bank deposits.

Negotiable Instruments Act, 1881: The Negotiable Instruments Act furnishes a legal structure for negotiable instruments like promissory notes, bills of exchange, and cheques. It regulates the rights and responsibility regarding the transferability of parties involved and guidelines for their settlement and implementation. This act holds significance in the banking sector as cheques are commonly employed as a mode of payment and reconciliation.

Prevention of Money Laundering Act, 2002: Money laundering in any country creates danger to the financial system as well as the economy of the country. This act prevents the practices of money laundering and funding to terrorism. Financial intelligence unit is created as per the provisions of PMLA act as a main agency which is responsible for getting and analyzing information and share those information's which are suspicious in nature. The responsibilities of the banks are fixed by this act to maintain

records, reporting of transactions and identity verification of customers

Sarfaesi Act, 2002: The SARFAESI Act established a legal structure for securitization and reconstruction of financial assets, along with enforcement of security interests. It empowers banks to seize and sell assets of borrowers in default to retrieve outstanding dues without requiring court intervention. This act grants banks the authority to issue notification, seize secured assets, and implement security interests.

Insolvency and Bankruptcy Code (IBC) 2016: It is basically a law that deals with proceedings of bankruptcy and insolvency of Companies, partnership firms and individuals. It provides effective and prompt resolution to the stressed assets. A board named insolvency and bankruptcy has been established by this law to supervise the petitioners of insolvency and units which are engaged in proceeding of insolvency.

Foreign Exchange Management Act (FEMA) 1999: FEMA is a crucial act that regulates foreign exchange dealings, international trade, and financial transactions in India. It substituted the former FERA Act. FEMA grant the RBI the authority to oversee and manage foreign exchange dealings, capital movements, and external borrowings. It also regulates FDI and external direct investment in India.

Current Scenario

Supply chain and logistics has been disrupted in 2021 due the covid-19 pandemic surges at global level. To achieve the objectives of long-term economic growth, the committee of monetary policy opted to maintain the same rate of repo. Further, Reserve Bank of India made efforts to fulfill the credit needs of industry by:

- Providing various refinancing options to all financial institutions of India.
- Providing facility of term liquidity for funding the services and infrastructure pertaining to covid healthcare.
- Providing special repo operation to small finance banks for long time period.

Substantial changes have been experienced by Indian banking industry in the last decade, transitioning from being the principal industrial lender to becoming the leading provider of personal loans, vehicles loans, housing loans and credit card. Private banks are increasingly emerging as the dominant leaders in the country replacing public sector banks. In the era 2016-2021, there was an increase in outstanding loans of PSBs by Rs. 14.4 trillion while outstanding loans of private sectors have increased by Rs. 22.8 trillion. There is a difference of nearly 60 percent. The growth of e-banking is another recent development in Indian banking sector. It is most important in offering better services to clients. Some techniques are used in e-banking such as mobile banking, e-wallets and internet banking.

Banking Reforms in India

The banking sectors reforms were launched in India for increasing the efficiency, stability, and effectiveness of banks. Following are the main reforms:

1. Nationalization of Banks (1969 and 1980): In 1969, the Government of India, led by Prime Minister Indira Gandhi, undertook the nationalized 14 prominent banks, which accounted for about 85% of the banking sector. This step was aimed at fostering financial inclusion, expanding banking services to rural regions, and diminishing the impact of private capitalists in the banking industry. In 1980, six more banks were nationalized.

2. Liberalization and Reforms (1991): India earmarked economic liberalization and financial sector reforms in 1991 led by Finance Minister Dr. Manmohan Singh. This era witnessed the implementation of measures like reduced government control, dismantling of the License Raj, and encouragement of private and foreign banks to enter the Indian market. The Narasimham Committee reports (1991 and 1998) played a central role in reshaping these reforms.

3. Introduction of New Banking Technologies: In the 1990s and 2000s, Indian banks adopted technology resulting in the computerization of banking operations, the introduction of Automated Teller Machines (ATMs), and the initiation of online banking services.

4. Banking Regulation Act Amendments (1993): The Banking Regulation Act underwent modification in 1993 to bestow greater independence and adaptability to the RBI in overseeing banks. This enabled the RBI to set prudential standards and regulations accordance with global benchmarks.

5. Asset Quality Review (2015): To tackle the problem of non-performing assets (NPAs) in Indian banks, the RBI carried out a comprehensive Asset Quality Review (AQR) in 2015. This aided in pinpointing stressed assets and enhancing transparency in reporting.

6. Payment and Digital Banking Reforms: Digital banking reforms means innovations within the banking sector to enhance and modernize banking services. India introduced various initiatives to boost digital payments and financial inclusion, including the Pradhan Mantri Jan Dhan Yojana (PMJDY), Aadhaar-based identification, and the Unified Payments Interface (UPI). Banks are using artificial intelligence based chat bots and virtual assistants for the purpose of customer support, fraud detection and personalized financial advice.

7. Bankruptcy and Insolvency Code (2016): The enactment of the Insolvency and Bankruptcy Code (IBC) in 2016 sought to streamline the procedure for resolving financial distress among companies, including banks. The code introduced the concept of insolvency professionals who play a significant role in managing the insolvency resolution procedures.

8. Merger of Public Sector Banks (2019): The government initiated a significant merger of public sector banks to strengthen the banking sector. The aims of merger were to improve operational efficiency, streamline the operations of banks and create stronger banks. Oriental bank of India and united bank of India were merged with Punjab National Bank to create second largest bank of India. Government of

India believed that larger banks will be better equipped to support the economic growth.

9. National Asset Reconstruction Company Limited: It was established with the recommendations of Union Budget for the session 2021-22. The main purpose of NARCL is to create a bad bank. It would house the bad loans of Rs. 500 crores and above. Already 28 Assets reconstruction companies are working in the market. But there is a need of more NARCL for controlling the amount NPA.

10. Digital Rupee: Digital currency such as digital rupee of RBI was announced in the budget for the session 2022-23. It will be launched by the end of this financial year. The digital economy of India will get benefits from this introduction of digital rupee.

- It is a token legal currency of nation or digital representation.
- It provides many benefits to customers such as more convenient transactions with faster settlement and better liquidity.
- The access of digital currency will be increased as UPI transactions.
- The adoption of digital rupee will help cross border remittances and decrease the cost of transactions for government and corporate sector.
- The settlement risk would be low in the financial system.

Impact of Banking Sector Reforms on Indian Economy

Banking sector reforms in India have a significant impact on the country's financial landscape. The impact of these reforms is as under:

1. Streamlined Taxation: The introduction of GST in 2017 marked a significant economic reform. It aimed to establish a unified tax structure nationwide, replacing various indirect taxes. This simplified taxation yields positive outcomes for the Indian economy such as improved ease of doing business and a decrease in tax avoidance.

2. Banking Sector Integration: GST mandated a significant level of integration within the banking sector. Banks had to adapt their systems to manage GST-related transactions, including the collection, payment, and reconciliation of GST. This integration showcased the importance of a robust and modern banking system to support complex economic reforms.

3. Increased Efficiency: these reforms have encouraged competition and efficiency within the banking industry. New private sector banks and foreign banks have entered in the market and forced traditional banks to enhance their services and operations.

4. Financial Inclusion: It refers to availability and accessibility of banking services such as banking savings, credit and insurance to all the segments of society especially for weaker sections of the society. The aims of financial inclusion are to promote economic stability and enhance the financial well-being of individuals. Government Initiatives like Jan Dhan Yojana and the promotion of microfinance have played a significant role in integrating the population into formal banking system, mitigating financial exclusion.

5. Regulatory Changes: The establishment of the Reserve Bank of India (RBI) as the central banking authority has strengthened regulatory oversight, resulting in more stability in the financial system.

6. NPAs and Asset Quality: Reforms related to NPA and Assets qualities are important for maintaining the stability of financial institutions. Reforms have brought to the light the issue of non-performing assets and prompted endeavors to tackle this challenge. The Insolvency and Bankruptcy Code (IBC) was a significant step in this direction.

7. Technology Adoption: The banking sector has adopted technology that giving rise to the expansion of online banking, mobile banking, and digital payment systems. This has made banking services more accessible and user friendly.

8. Foreign Investment: Banking sector reforms have significant impact on foreign investment. These reforms enhanced the stability of banking sector, streamlined banking regulations and addressed the non-performing assets which lead to attract the foreign investment in the banking sector, providing access to capital and global expertise.

9. Financial Stability: Banking sectors reforms aim to enhance risk management practices in banks such as strict regulations of lending practices and capital adequacy requirement. They would not engage in risky activities. Thus, it leads to financial stability. These reforms contributed to greater financial stability, although challenges like cyber threats and the need for continued vigilance against fraud persist.

10. Financial Literacy: Some banking reforms include provisions financial education and literacy programs. Government and regulatory authorities may require bank to offer financial literacy resources to their customers. Efforts have been made to increase financial literacy among the population, helping people make informed financial decisions.

11. Improved Tax Compliance: The transparency and accountability brought about by GST have improved tax compliance. This, in turn, has the potential to increase government revenue, which can be used for various developmental projects. The gross GST revenue collected in the month of August, 2023 is Rs. 1,59,069 crore. While banking sector reforms have brought numerous benefits, there have also been challenges and areas that require further attention. The success of these reforms will continue to shape India's financial landscape in the years to come.

Performance of PSBs

There is a significant improvement in the performance of PSBs after the implementation of banking reforms. These are as follow:

a. The quality of assets of PSBs has improved substantially with gross NPA ratio which is declined from 14.6% in March 2022 to 5.53% in December 2022.

- b. There is an increase in resilience with provision coverage ratio of PSBs which is raised from 46% in March to 89.9% in December 2022.
- c. There is a significant improvement in capital adequacy ratio of PSBs. It has been raised from 11.5 percent in March to 14.5 percent in December 2022.
- d. All PSBs are showing the profits with total profit of Rs. 66,543 crore in financial year 2021-22 and total profit for the financial year 2022-23 is observed as 70,167 crore.
- e. An improvement can be noticed in the total market cap of PSBs. In march 2018, it was Rs. 4.52 lakhs crore while in December 2022, it is 10.63 lakhs crore.
- f. Banks, earlier placed under Prompt Corrective Action (PCA) framework by RBI, have made significant improvement resulting in removal of each one of them from the PCA restrictions.

Conclusion

These reforms have revolutionized the Indian banking sector, rendering it more competitive, efficient, and technologically advanced. These reforms have also played a vital role in fostering the economic growth and financial inclusion efforts in India. However, challenges such as NPAs, governance issues, and the need for continued innovation remain on the agenda for further reform. The banking sector reforms in India have been a dynamic and ongoing process aimed at modernizing and strengthening the country's financial system. Over the years, these reforms have significant impacts on various aspects of the banking industry and the broader economy.

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