IDBI Bank: The door to denationalisation*

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Officers and other employees of the public sector IDBI Bank, organised under the banner of the United Forum of IDBI Officers and Employees, struck work for a day on November 27 protesting against the government's decision to privatise the bank. Officers and workers in the rest of the public banking industry, represented by the All India Bank Officers' Association and the All India Bank Employees' Association, have extended support to the struggle launched by the IDBI workforce, sensing that this move by the NDA government begins a process that could lead to denationalisation of India's banking industry.

Ever since the adoption of a policy of financial liberalisation in the early 1990s, there has been a vocal group of neoliberal 'reformers' who have argued for the privatisation of the public banking industry. Their case was not that little progress was made in ensuring that the banking sector served the objectives of national development in the years between nationalisation in 1969 and liberalisation in the 1990s. The evidence was clear that in terms of reach, credit provision, and allocation to hitherto neglected sectors like agriculture and small-scale industry, nationalisation had dramatically transformed the banking industry for the better. While couched in arguments that referred to factors like low profitability, high level of non-performing assets, and poor quality of service, the demand for privatisation was a reaction against the fact that banks were no more the agents of corporate capital as they were before 1969, allocating most of their resources to big industry and disproportionately to firms in which the owners or directors of the banks concerned had an interest. Profitability was never meant to be the principal objective of a public banking system that was created to support broad-based and inclusive growth, without sacrificing stability. State ownership ensured it played its role as a development instrument. And the sovereign guarantee of the state, which as owner was committed to easing liquidity constraints and to recapitalising banks if and when required, ensured stability.

The grounds for corporate opposition to the public banking system lay elsewhere. Banks are entities established with a small amount of promoters' capital that mobilise large volumes of resources from the public at large. Control over those resources ensures financial power with low risk. Big private capital in India never forgave the then government for having deprived it of control of those resources through nationalisation in 1969. Financial liberalisers favouring privatisation are working to restore that control.

The problem is that in India's still vibrant democracy, privatising a public sector bank, in the sense of handing over control to a private entity through disinvestment or otherwise, requires parliamentary assent. Winning such assent is not easy. This is not just because of ideological differences. The dangers of private control evident in the mid 1960s, when the banking system, excepting for the State Bank of India and its associates, was in private hands, are not easily forgotten. For example, at that time only 2 per cent of total bank credit flowed to agriculture, though the sector accounted for around 40 per cent of GDP. Besides, the evidence that matters changed hugely from a development point of view after nationalisation cannot be easily erased.

For that reason, the policy adopted by government committed to financial liberalisation has been one of creeping privatisation, with government diluting its holding by selling small chunks of shares through the market. As of end-March 2015, government shareholding in 12 out of 22 public sector banks was less than 70 per cent, with the figure being less than 60 per cent in five of them. But disinvestment of this kind cannot transfer control, especially if there are restrictions on ownership by a single holder and on voting rights of large shareholders. To address this problem the government and the liberalisation lobby have been raising the bogey of Basel III. Meeting the capital adequacy norms set by the Basel Committee requires, according to this section, substantial recapitalisation of banks. Since such capital cannot come from the budget given fiscal constraints, issue of new equity is the only alternative. And that would require reducing the government's shareholding below 50 per cent if necessary. Moreover, it is argued, the success of the disinvestment exercise may require handing over control to a private sector entity.

The aim here is to separate the question of bank stability from bank ownership. Meeting Basel III norms, acceptance and implementation of which is not an international treaty-driven imperative, is presented as a technical requirement for bank stability, which it is not. So if stability requires transfer of control, it is argued, that is the way to go. This ignores the fact that sovereign backing from the government and the central bank itself is adequate to ensure stability, especially when fiscal constraints are the result of an unwillingness to impose progressive taxes and a senseless acceptance of stringent ceilings on the extent of deficit financing. Clearly Basel norms are merely the peg on which the independent privatisation thrust is being hung.

But the constraints set by democracy are still a hurdle. So when the government recently granted 7 public sector banks permission to raise capital through equity issue in the market to meet their capital requirements, they were still subject to a December 2014 guideline that the government's holding must be kept at a minimum of 52 per cent.

It is in this background that the decision to privatise IDBI through either a share sale or an exercise in strategic disinvestment has to be seen. The issue is being presented as just another case in the government's disinvestment effort, budgeted to raise Rs. 69,500 crore this financial year, rather than the privatisation of a public sector bank. Bad management leading to losses cannot be an argument because IDBI Bank recorded a pofit of Rs. 873 crore in 2014-15. In fact, the disinvestment that would bring the government's holding of 76.5 per cent to below 51 per cent is being justified on grounds varying from budgetary needs to the efficacy of private management and monitoring of managerial performance. But there is adequate reason to believe that the principal aim does seem to be that of starting off the process of privatisation and denationalisation of the public sector banking system.

The objective clearly is to strike at the weakest link in the public banking system. As mentioned, even as of now, the government can dilute its share in all nationalised banks only up to 52 per cent. But in the case of IDBI, its privatisation would not violate this guideline, because, though still a bank under majority government ownership, for historical reasons it is no more an entity requiring parliamentary approval for transfer of ownership to the private sector. The original Industrial Development Bank of India was established in 1964 through an Act of Parliament as an apex institutions sitting atop India's large and diverse development banking infrastructure. As a development bank, IDBI was fundamentally different from commercial banks whether public or private. It was a wholly owned subsidiary of the central bank and banking regulator, and was not a typical deposit taking institution, but got support in the form of concessional capital from the budget and the central bank to execute its mandate. That mandate was to help close the gap in long term financing and help overcome inadequacies and deficiencies in terms of industrial entrepreneurship and expertise in India's still fledgling modern industrial sector. Thus IDBI's mandate was very different from that applicable to a typical commercial bank.

Matters changed with the onset of financial liberalisation when it was decided to do away with the policy of directed credit aimed at developmentally important sectors (often at concessional interest rates), and do away with the distinction between development banking and commercial banking. IDBI was an early casualty, when it was decided to convert it into a commercial bank. The process involved a number of steps. To start with the parliament passed the Industrial Development Bank (Transfer of Undertaking and Repeal) Act, 2003, which allowed the transfer of the erstwhile IDBI to a new government company, IDBI Ltd, established under the Companies Act. Further, in 2005, IDBI Bank Ltd, established as a wholly owned subsidiary of IDBI Ltd to undertake commercial banking activities was merged with IDBI Ltd, under the voluntary amalgamation provisions of the Banking Regulation Act. Finally, in 2008 the name of the company was changed from IDBI Ltd to IDBI Bank Ltd to reflect its changed functions.

Though the process was complex, it essentially involved the reverse merger of a development bank into a commercial bank, to undermine the development banking function and replace it with predominantly commercial banking functions. But this history meant that unlike the private banks that were nationalised in 1969 and later, IDBI Bank was a company in which the government had the right to reduce its stake without parliamentary approval, but subject to the Reserve Bank of India provisions with regard to bank ownership and control. Using this, the privatisation of IDBI Bank is being presented as one more instance in a larger disinvestment process. Thus, the choice of IDBI Bank as the target for privatisation is explained by its special status given its unusual history that frees the government from the need for parliamentary approval at this stage.

This has happened before with UTI Bank, which was subsequently rechristened 'Axis Bank' and treated as a new generation private bank despite significant ownership by the original promoters UTI (subsequently SUUTI), Life Insurance Corporation and other government owned insurance companies. In time the shareholding of these public entities was divested, making Axis a "truly" private bank. Presently the original publicly owned promoters hold around 30 per cent of the shares, with 46 per cent being owned by foreign investors.

The trajectory of IDBI Bank is similar. But this time around the objective behind disinvestment is clearer. This is the start of a larger process of denationalisation of banking in India. If that project succeeds, India would be returning to a banking structure that is not merely hugely excluding, but also most unsuited to India's development needs. The opposition from the employees in IDBI Bank and elsewhere in the banking industry is, therefore, likely to gain wider support and greater momentum.

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