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BANK NATIONALIZATION AND SOCIAL CONTROL OVER BANKING

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ABSTRACT

A bank is a financial institution or an organisation that keeps the money that accepts deposits and money from public and in turn creates a demand deposit while simultaneously creating loan demands. These are basically financial service providers that provide the citizens with a safe and a profitable platform to store their valuables. Money or cash are not the only things that are accepted by banks but also other valuables like gold. The etymological derivation of this term differs from time to time and it even varies according to the country because each of them has its own unique way of understanding and carrying out the banking procedures.

Though some of the features of bank like acceptance of deposits in current accounts for customers and collecting and paying cheques for them have been universally accepted as the basic functions of a bank without any arguments. The positive and Negative impact of nationalization or examines the pre and post Nationalization Era. Moreover, it also emphasises the Need of Nationalization. Furthermore, this paper talks about the social control over banking. Thereafter, suggests the final thought pertaining to the concept of Nationalization and social control over Bankin

INTRODUCTION

Bank nationalization in India started with the government nationalising the 14 largest commercial banks on 19 July 1969 through the Banking Companies (Acquisition and Transfer of Undertakings) Ordinance, 1969. These banks held about 80% of the entire bank deposits in the country. In 1980 another six private banks were nationalised. Until 1969, the State Bank of India was the only bank not privately owned. Before its nationalisation in 1955 It was called the

Imperial Bank. Currently, India has 19 nationalised banks.

There are various reasons for the occurrence of such nationalization. One of the major reasons is to energise priority sectors. The agricultural sector was ignored for a very long time by commercial banks. These banks were seen as catering to only large industries and businesses. Approx. 2.3% of the bank loans were channelled to farmers, in 1950, with the figure declining to 2.2% in the next 17 years. The government also wanted to open new branches in the rural and backward areas. The government also wanted to mobilize savings through nationalisation and utilize them for better and more productive purposes leading to efficiency. There were various economic and political reasons as well. Bank nationalization was one of her responses to the economic and political challenges of the time. E.g., the wars with China in 1962 and Pakistan in 1965—put pressure on public finances.

The private sector banks being predominantly urban oriented and controlled by few large industrialists were not properly equipped to help the achievement of the basic socio-economic objectives. The credit needs of agriculture, small scale industries and weaker sections were totally neglected.

HISTORY OF BANK AND CONCEPT OF NATIONALIZATION

The term 'bank' is something that is not a novice concept. This term is supposed to have its origin from a Latin word 'Banches' or an Italian word 'Banco' both of which translates to 'bench'. It is also said that this word has been derived from a German word 'Back' which means 'Joint Stock Fund'.¹

In the case of the Greeks and the Babylonians the temples were used as a form of banks wherein the money was lent to people and this was majorly done by the priests who were appointed specifically for this task. Temples were the major centres of money lending transactions in the earlier times. This was a successful method until there started to occur religious clashes and disbeliefs. In each religion it was clearly stated in their own unique way that taking interest rates or extra charges for their own money was not an acceptable condition.

With this temple being used as banks came to an end. Rather it was modernised and turned into a new concept which was practical in all aspects. This form of money lending was first introduced in the city of Venice in the mid of 12th century, in the year 1157.

In India the concept of banking has existed since the Vedic period which extends from around 2000 BC to 1400 BC. During those times lending of money was considered as an art rather than a business or trade. There was a very slow and steady transition from money lending to banking in that period. After that both money lending and banking existed separately in the Mahabharata and Ramayana era which are considered to be the events of life that took place between 1000 and 700 B.C. During and even after independence India there was a huge need for nationalization in the country. This was majorly because a lot of were there of requirements of big businesses and also of large markets. Following which exports, agriculture and small industries were hanging back. Nationalization of banks solved the major chunk of all these problems and it also gave a financial boost to the country. The other sectors that were lagging like the small markets, agriculture or farming obtained a boost. That itself was a huge success for the nation as India as a whole was majorly dependent on its agricultural sector. This in turn led to a sudden rise in funds following which the economic condition of the country started aiming and reaching towards its zenith.

Before nationalisation took place in 1969, only State Bank of India was a public sector undertaking. It was also the first nationalized bank of India which was earlier known as the Imperial Bank of India. In the year 1951, there were more than 400 commercial banks who worked under the private sector. More than 360 banks had failed or collapsed between 1947 and 1955. The rate at which the banks were collapsing was around 40 banks within a duration of one year. This in turn resulted to a huge loss for the people who had invested their money in those particular banks and also affected the economy of our country on a large scale. This trend of collapsing of banks continued throughout the 1950s till the first half of 1960s.

This situation had forced the then finance minister Mr. Morarji Desai, under the leadership of Jawaharlal Nehru as the Prime Minister, to launch a massive bank consolidation drive. It brought down the number of banks from 328 in 1960 to 68 in 1965.²

¹ History Of Banking, Wikipedia, https://en.wikipedia.org/wiki/History_of_banking,

² Nationalization of Banks in India, Zee Business, <https://www.zeebiz.com/india/news-nationalisation-of-banks-in-india-history-effect-19-july-1969-bank-list-how-many-banks-are-nationalised-upsc-trending-indian-economy-190160>,



WHAT IS NATIONALIZATION

The concept of nationalization is not just limited to banks but also various other sectors or working organisations that exist in the country. Mainly those which are privately owned by individuals or other entities. It also brings these entities under the public ownership of a national government or state. This would widen the parameters of control that the government has over the state as well as the citizens of the nation. As per the International Monetary Fund (IMF) Nationalisation is a process by which the government takes over private assets and brings them under public ownership.

There is a fine line of difference between nationalization and privatisation and with demutualization. Privatization is a concept in contrast wherein the ownership and management are transferred from public to private sector. On the other hand, demutualization is basically a process in which a customer owned mutual organization or co-operative changes legal form to a joint stock company.

The term "Nationalization" refers to the transformation of the Private industry or commerce into a state owned or public owned commerce. Subsequently, Nationalization of Banks refer to the acquisition of majority of the stake of private banks and transforming it into a public ownership of a national government. The First Bank to get nationalized was Reserve Bank of India (RBI) on 1st Jan, 1949. Through Transfer of Public Ownership Act. Thereafter, in 1969 and 1980, 14 and 6 Commercial bank of India underwent the process of Nationalization respectively.³ Moreover, Banking companies (Transfer of Undertakings and Acquisition) Act, 1970 was passed keeping in view to take over certain Banking institutions.

NATIONALIZATION OF BANKS

The history of Nationalization can be traced back in the 1947 also known as the independence period. It's the time when the banking system in India was established. It started with the foundation of Bank of Hindustan in the year 1770. There are many banks that started operating during those days and are well known in operation now as well. Like Allahabad bank, Punjab National Bank, etc. this period is also known as the merging period where most of the banks were merged with one another. The Imperial bank is one of the biggest epitomes in that regard which is

a merger of Bank of Madras, Bank of Bombay and Bank of Bengal which later turned into what we know as the 'Reserve Bank of India'. Thereafter, second phase initiated from 1947 to 1991 which was majorly known as the Nationalizing period for the banks in India. Indira Gandhi, the Prime Minister that time put up a proposal for the same on behalf of the Central government and thereafter the Government of India started issuing ordinance of Banking Companies (Acquisition and Transfer of Undertakings) 1969.

The following 14 Banks were nationalized in 1969:

1. Central Bank of India
2. Bank of Maharashtra

³ [https://rbi.org.in/history/Brief Chro1935to1949.htm](https://rbi.org.in/history/Brief%20Chro1935to1949.htm)



3. Dena Bank
4. Punjab National Bank
5. Syndicate Bank
6. Canara Bank
7. Indian Bank
8. Indian Overseas Bank
9. Bank of Baroda
10. Union Bank
11. Allahabad Bank
12. United Bank of India
13. United commercial Bank
14. Bank of India

Eventually in 1980 six more private banks were nationalised to the earlier 14 major banks. The names of these six banks are as follows:

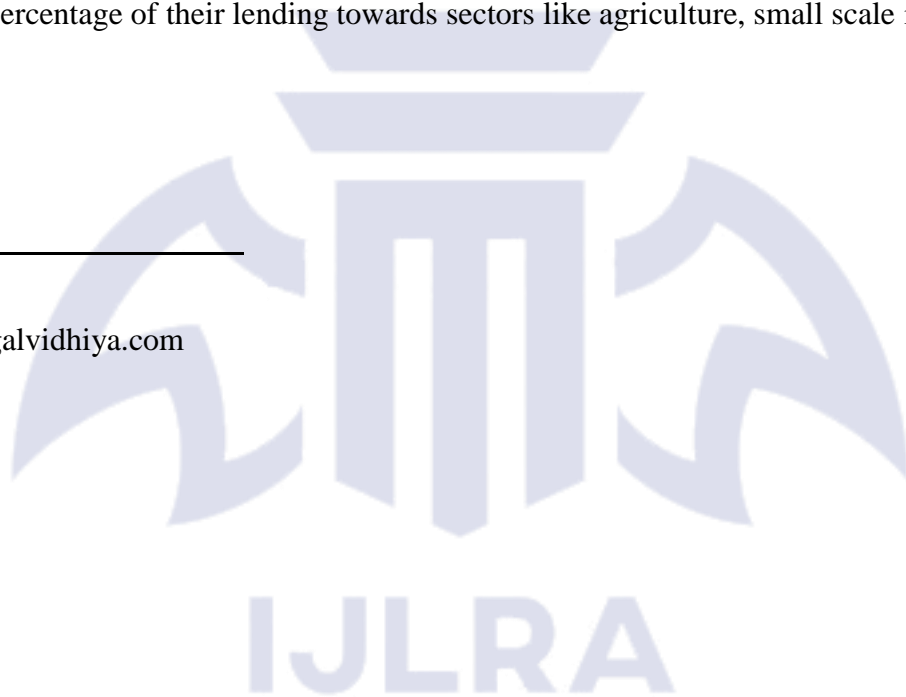
- Andhra Bank
- Corporation Bank
- New Bank of India
- Oriental Bank of Commerce
- Punjab and Sind Bank
- Vijaya Bank

An overview of the benefits of this step is that the banks were spreading their branch networks throughout the country, nation-wide deployment of credit and increased mobilization of resources. The reason behind the immense development of the Indian banking system was this

process of nationalization that was implemented in our country. This happened soon after independence wherein people were in dire need of access to various facilities but at the same time had no idea or knowledge about the same. Thus, nationalization solved this issue as it brought the procedure or access of banks easy and equal to all citizens.

Banks had been taken under the government control in many nations. When we specifically talk about the case of India the nationalization process took place in majorly two phases, the first one on July 19, 1969 and the second one on April 15, 1980. During the first phase such a step was taken in order to promote social welfare, increase credit availability in rural areas, and reduce concentration of economic power.⁴ The nationalized banks had to mandatorily shift a certain amount or percentage of their lending towards sectors like agriculture, small scale industries and exports.

⁴ <https://legalvidhiya.com>



When banks were nationalized, it came directly under the control of the Banking Regulation Act, 1949. RBI later became the regulatory authority for banking in India.

NEED OF NATIONALIZATION

Nationalization, per se strives for a well-managed banking system. An effectively Administered financial institutions aid country's huge businesses and industries. Some of the main reasons for the need of nationalization are discussed below:

1. Focus on backward areas: The foremost essence of nationalization is to create development and reach the mass. Private banks were neglecting the backward areas of the society and were solely focusing on the urban areas. Nationalization was indispensable as it helped backward areas by providing loans and other banking facilities in order to create development and bridge the gaps between urban and rural areas.
2. Prioritizing Crucial sectors: Sectors like: small scale industries, cottage industries, agricultural industries and more were being neglected by the private banks. Nationalization of banking institutions strive to effectively develop these crucial sectors of our society
3. Creation of Banking Habitat: Like Hospitals, Schools, Collages. Banks have also become an Integral part of our society which indeed is one of the chief principles of Nationalization, is to create banking habitat.
4. Increase in Profit: Authority of government over Banking sector generates higher revenue which ultimately provides higher capital formation which further can be invested in large scale projects or industries.
5. Rapid transfer of funds: When more people imbibe banking habits, transactions in the country will be done with usage of banks. The need for currency or hard cash will slowly decline. Which ultimately refrains Unaccounted transactions and the generation of black money. Funds can be transferred with the use of electronic media. Hence, Economic activity will speed up. Ultimately increase in the revenue of the government.
6. Creation of Institutions: Creation of new institutes like NABARD, SIDBI, etc., suffice the

necessity of Agricultural sector, Trade or Foreign Trade of the society.

SOCIAL CONTROL OVER BANKING

India had adopted the socialism pattern of society as its prime objective after Independence owing to which the concept of social control has emerged in India. Which denotes that the wealth ought to be distributed equitably without making the country a totalitarian state and achieve it via democratic process. Banks being the custodian of Savings and an institution of granting credits. The term “social control” came into consideration as the banks advances were only directed towards the medium and large-scale industries. Basically, the small-scale industries like Agriculture, cottage industries, export industries, etc., were being neglected. Owing to this mismanagement in the banking sector, the need of Nationalization was proposed.

The social control empowered via Banking laws (Amendment) Act, 1968 which Amended the Banking regulation Act, 1949. The prime objective of social control focused on providing accessibility in backward areas. Around 196 Regional rural banks (RRBs) were established.⁵ The then Prime Minister, Morarji Desai further stated that the foremost objective of Social Control was “To regulate our social and economic life so as to attain the optimum growth rate for our economy”⁶

CASE: R.C. Cooper v. Union of India (Bank Nationalization Case)⁷

On 19th July, 1969. The vice president of India passed an ordinance whilst exercising the power under Article 123(1) of the constitution of India. A petition was filed against the same. ii. Nevertheless, On 9th August, 1969. The banking companies (Acquisition and transfer of undertaking Act, 1969) ordinance, 1969 was passed which repealed the Banking companies (Acquisition and Transfer of undertakings) ordinance, 1969. In the above case the petitioner rose the following issues: 1. Firstly, the act of passing the ordinance was void as it was beyond the legislative competence of the central government. 2. Act is creating discrimination between the banks. Held: A bench of 11 judges of the supreme court heard the petition and held that the act was within the legislative competence of the central government.

ARGUMENTS IN FAVOR OF NATIONALIZATION OF COMMERCIAL BANKS IN INDIA:⁸

Various factors were responsible for the nationalization of commercial banks in India. discussion on these factors that helped in this, are as follows:

1) Too much concentration in the banking sector:

In 1959 there were 570 banks in India. But in 1963 the number came down to 276. However, during this period the amount of bank deposit had increased by more than two times. This shows too much concentration in the banking sector. Again, out of 276 banks just 5 banks contributed to more than 50% of the deposits. The big industrialists used the bank funds to build up their industrial empires. This implies concentration of economic power. It was thought that the nationalization of commercial banks would solve it.

2) Mobilized savings were not used for social development:

According to an estimate there were 188 directors in 20 commercial banks. These directors used to control 1,640 companies. As a result, the savings of the commercial banks were used for the promotion of the interests of a few groups of people. This was not utilized for general economic development.

3) Hoarding of essential commodities of speculation:

The speculators could get higher profits as the general price level increased. These speculators used to take loans from commercial banks. Thus, in order to check these speculative activities the nationalization of commercial banks was thought to be essential.

4) To check illegal activities: According to Indian Companies Act, each company has to submit the estimates of profit and loss to the Registrar of Companies. However, the provision was not applicable to the banking companies. The bank could hold secret reserve funds and declared lower profits. These funds were used to purchase shares of different companies. The

⁵ <https://www.livemint.com/industry/banking/bank-nationalization-stands-the-test-of-time->

⁶ <https://theintactone.com/2019/09/14/ibs-u3-topic-1-banking-regulation-act-19>

⁷ <https://www.iasexpress.net/nationalisation-of-banks-in-india/>

⁸ <https://www.researchgate.net/>

banks were involved in under invoicing of exports and over invoicing of imports. It was thought that these illegal activities could be checked as a result of bank nationalization.

5) Urban bias: The banks were mostly confined to urban areas. They did not pay any attention to opening of new branches in rural areas. But in order to have all round development of the country there is need for opening up of new branches in rural areas. As a result of nationalization of commercial banks it was thought that branch expansion of banks in rural areas will be possible.

6) Discrimination against small business:

The banks lent money only to the big business units. They neglected the needs of the agricultural sector. But the development of agricultural sector is necessary for the economic development of the country. Agriculture is the priority sector. In order to ensure flow of credit to the priority sectors, bank nationalization was thought to be essential.

7) Stopping of failure of banks: Up to early 1960s there were a large number of bank failures in our country. This hampered the interest of the depositors. It was thought that through bank nationalization the confidence of the public in commercial banks would rise. This would also check the growth of black money in our country.

8) Improvement of service conditions of bank employees:

Nationalized banks would be able to provide better service conditions to their employees. The efficiency of the banking business would rise through better training.

PERFORMANCE OF NATIONALIZED COMMERCIAL BANKS SINCE NATIONALIZATION: ⁹

One of the major criticisms of commercial banks prior to nationalization was that they never extended their hands to the priority sectors like agriculture, small scale industries, exports etc. Before nationalization such banks operated with the profit motive only. But after nationalization the scene changed to a huge extent. Commercial banks started to consider objectives like social development and economic development of the nation. Thus, they started supporting sectors on which the growth of the then Indian economy was dependent heavily. The total credit provided by the public sector banks in 1969 was Rs. 440 crores. In 1988 it went up to a level of Rs,29,333 crores. Another massive change in the Indian banking scenario was observed as a result of nationalization of commercial banks. Previously, the private banks were operating with only the profit motive. So they were eager to operate and open their branches only in urban areas, where

scope of business was bigger and brighter than the rural areas. After nationalization of these banks, there was a gigantic change in the motives of these commercial banks. They were operating no more with just the profit motive. As a result of this, the commercial banks started to extend their services in the rural areas also. This had a manifold effect on the Indian economy. Firstly, due to this approach of the nationalized commercial banks there were more branches being opened in rural areas. Thus, the untapped rural market were also coming under the ambit of the Indian banking industry. Secondly, this was helping in generation of employment opportunities in the Indian job markets. Thirdly, from the point of view of consumer behavior it can be said that the vast population in the rural areas were being exposed to the banking services. In this context, it is mention worthy that since 1969 to 1989 there was 600% growth rate observed in the opening of new branches of commercial banks. Moreover, in June, 1969 on an average a branch of a bank was serving more than 65,000 customers in India. This number came down to 12,000 customers per branch in June, 1989. Another significant impact was felt in case of deposit mobilization. The deposits of commercial banks which stood at Rs. 4,650 crores in June, 1969 grew to Rs. 1,47,000 crores

⁹ <https://www.researchgate.net>

in January, 1989. However, in spite of these successes, there were also certain limitations of nationalization of commercial banks. Profitability of the commercial banks declined to a huge extent. Nationalization also made these commercial banks heavily dependent on the politicians. Thus large part of the bank credit was still being diverted towards the big industries and corporate houses. Lastly, it can be said that nationalization brought in security in the lives of the banking employees. This established a complacent attitude thereby resulting into a sharp decline in the standard of the banking services provided to the customers.

Conclusion

It can be said that due to nationalization of commercial banks the Indian banking industry faced a steep challenge. It was the challenge of blending the profit motive with the objective of social and economic development of the nation. The game of balancing these two diagonally opposite sets of goals is still on. These banks, there was a gigantic change in the motives of these commercial banks. They were operating no more with just the profit motive. As a result of this, the commercial banks started to extend their services in the rural areas also. This had a manifold effect on the Indian economy. In 1969, fourteen major commercial banks were nationalized in India. Foreign banks and other banks with deposits of less than Rs.50 crores were not nationalized. Six more commercial banks were nationalized in 1980. The nationalized commercial banks were at that time controlling 91% of total deposits and total credit. Nationalization of commercial banks in India is looked as a significant effort of the Government of India to strengthen the economy.

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