

THE ROLE OF PUBLIC SECTOR BANKS IN INDIA'S ECONOMIC GROWTH

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ABSTRACT

Public Sector Banks (PSBs) have been pivotal in molding the economic foundation of India by enabling credit access, ensuring financial inclusion, and advancing core sectors like agriculture, small and medium-sized enterprises (SMEs), and infrastructure development. PSBs, with their leadership presence in India's banking sector, form the financial backbone of the country. Their value addition goes beyond money transactions to address issues like poverty reduction, creation of employment opportunities, and industrial growth. This research examines the multi-dimensional role of PSBs in India's economic development, examining their role in infrastructure financing, credit delivery to priority sectors, and financial inclusion programs. Through the extension of affordable financial services to poor people, PSBs have played a major role in narrowing the urban-rural gap and facilitating equitable economic development. Despite that, these banks continue to struggle with issues such as increasing NPAs, regulatory pressures, and competition from foreign and private sector banks. These inefficiencies of governance and bureaucratic bottlenecks also restrict their operational efficiency to some extent, raising questions over their long-run viability. The article also analyzes the different reforms and policy interventions brought about by the Indian government and the Reserve Bank of India (RBI) to make PSBs more efficient and resilient. Initiatives like capital infusion, mergers of banks, digitization, and better credit risk management have played a key role in strengthening the banking system. The launch of the Insolvency and Bankruptcy Code (IBC) has also contributed importantly towards enhancing the credit recovery mechanisms and solving the problem of bad loans. PSBs, despite all the setbacks, remain an indispensable part of India's financial system, facilitating inclusive growth and economic development. The research concludes that although structural vulnerabilities are present, strategic reforms, technology uptake, and good governance can guarantee the long-term sustainability and competitiveness of PSBs. The future initiatives should be aimed at enhancing risk management frameworks, improving operational efficiency through digitalization, and creating a more customer-oriented banking experience. Through these interventions, PSBs can continue to remain an integral part of India's journey to a \$5 trillion economy.

Keywords: PSBs, NPAs, IBC, SMEs, RBI.

Introduction

The banking industry is the pillar of any economy, providing financial intermediation, mobilizing savings, and channeling capital into productive investments. In India, Public Sector Banks (PSBs) are the driving force behind economic growth by providing financial stability, lending support to priority sectors, and ensuring financial inclusion. As of 2023, PSBs hold approximately 60% of the total banking assets in India, which makes them a powerful force in the Indian financial sector.

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Since India gained independence, PSBs have been at the center of planned economic growth in the nation. Their main purpose goes beyond profit maximization since they also concentrate on social banking, making sure that financial services are extended to all segments of society, such as rural and poor communities. The bank nationalization in 1969 was a historic turn of events which consolidated the contribution of PSBs towards promoting economic development by enlarging the spread of banking operations to reach more people. The PSBs during the decades subsidized major sectors including agriculture, SMEs, housing, and infrastructural development which enabled India's transformation into an internationally competitive economy.

One of the significant contributions of PSBs is financial inclusion, which has been the bedrock of India's economic policy. Programs such as Pradhan Mantri Jan Dhan Yojana (PMJDY) have helped crores of Indians access banking services, thus economically empowering them. Further, PSBs have played a crucial role in credit dispersal for priority sectors, offering financial support to farmers, entrepreneurs, and small enterprises. They also contribute significantly to financing major infrastructure projects, which are necessary for supporting economic growth and the generation of employment.

Though their role in economic development cannot be overstated, PSBs encounter various problems, including mounting non-performing assets (NPAs), regulatory hurdles, interference from politics, and operational inefficiency. The increasing competition from private and foreign banks, which provide superior customer services and online banking facilities, also put pressure on PSBs to improve their efficiency and technological setup.

To meet these issues, the RBI and the government of India have initiated several reforms, such as bank recapitalization, mergers of low-performing banks, introduction of digital banking tools, and stronger risk management rules. The Insolvency and Bankruptcy Code has been an important measure in strengthening credit recovery channels, allowing PSBs to alleviate the bad loans problem.

The following paper seeks to examine the changing role of PSBs in Indian economic development, their contributions, challenges, and future prospects. Through the discussion of recent reforms and technological advancements, the research will seek to understand how PSBs can be made more efficient and competitive in a rapidly changing financial landscape. In spite of the challenges, PSBs continue to be the backbone of India's economic setup, and whether they can continue to innovate and adapt will prove to be crucial for their long-term viability and contribution to the country's growth.

The Role of Public Sector Banks in Economic Growth

- **Infrastructure Financing**

Infrastructure development is a key driver of economic growth. PSBs provide long-term financing to large-scale projects in transportation, energy, and urban development. Institutions like the State Bank of India (SBI) and Punjab National Bank (PNB) have significantly contributed to infrastructure growth by financing highways, power plants, and industrial corridors.

- **Credit Disbursement to Priority Sectors**

PSBs support sectors critical to economic development, such as agriculture, micro, small, and medium enterprises (MSMEs), and housing. The Priority Sector Lending (PSL) mandate ensures that banks allocate a portion of their total credit to these sectors, fostering inclusive growth. Government-backed schemes such as the Pradhan Mantri Mudra Yojana (PMMY) have been instrumental in providing financial support to small businesses through PSBs.

- **Financial Inclusion Initiatives**

Financial inclusion is essential for economic empowerment, particularly in rural and semi-urban areas. PSBs have played a leading role in implementing government initiatives like the Pradhan Mantri Jan Dhan Yojana (PMJDY), which aims to provide every household with access to a bank account. The expansion of banking services through digital platforms and rural banking branches has improved access to financial services for millions of Indians.

- **Employment Generation and Industrial Growth**

By offering credit facilities to industries and businesses, PSBs contribute to job creation and economic diversification. They facilitate entrepreneurship by providing capital for startups and MSMEs, thereby reducing unemployment and boosting economic productivity.

Challenges Faced by Public Sector Banks

Though they play a crucial part in India's economic development, Public Sector Banks (PSBs) encounter numerous challenges that influence their effectiveness, profitability, and competitiveness. Some of the significant challenges are:

- **High Non-Performing Assets (NPAs) and Loan Defaults**

One of the most critical issues facing PSBs is the extent of NPAs. Defaults by large corporate loans, weak credit risk assessment, and ineffective recovery mechanisms have contributed to an increase in bad loans. The gross NPA ratio of PSBs has been substantially higher than that of private sector banks, impacting their balance sheet and lending capacity.

- **Inefficiency and Bureaucratic Hurdles**

PSBs tend to be afflicted with bureaucratic inefficiencies, tardy decision-making, and inflexible operational structures, which make them less nimble than private banks. This impacts their competitiveness in a fast-changing financial industry where private and foreign banks provide quicker, technology-based banking services.

- **Limited Technological Adoption**

Though PSBs have taken steps to automate their banking products, they lag behind private banks in the use of AI-powered customer services, digital banking, and fintech partnerships. PSBs have a lot of obsolete IT infrastructure that exposes them to cyber attacks and operational inefficiency.

- **Political and Government Interference**

In contrast to private banks, PSBs are exposed to government intervention in decision-making, especially in loan sanctioning, appointments, and interest rate decisions. This tends to lead to directed lending to politically driven projects and financial strain due to populist schemes, e.g., loan waivers.

- **Low Profitability and Capital Constraints**

With great provisioning needs for NPAs and low efficiency of operations, PSBs also face profitability difficulties. They also become too dependent on government capital injection, with curtailment of financial independence. Capital adequacy continues to be a point of concern for those banks whose balance sheets are weak.

- **Increasing Competition from Private Sector Banks and Fintech Organizations**

PSBs are confronted with fierce competition from private sector banks, foreign banks, and fintech companies, which provide customer-oriented, technology-enabled financial services. Private banks have captured market share by offering superior digital banking experience, customized financial products, and quicker loan approvals.

- **Weak Governance and Risk Management**

Governance issues, lack of accountability, and weak risk assessment mechanisms have plagued the operations of PSBs in the past. Most loan scams and frauds have been traced to poor internal controls and weak credit monitoring systems.

- **Inability to Attract and Retain Talent**

Because of inflexible HR guidelines, fewer performance-linked incentives, and lower compensation levels than in private banks, PSBs find it difficult to retain and attract competent professionals. They are impacted by the inability to hire top performers and provide internal promotions based on their choices.

- **Regulatory Burden and Compliance Restrictions**

PSBs operate under tight control of RBI and the government, necessary for their financial stability, which also entails disproportionate compliance costs. This ends up causing a slow decision-making process, lack of operational efficiency, and conservative lending.

- **Effect of Economic Slowing and External Shocks**

PSBs are severely vulnerable to macroeconomic shocks, and their financial condition tends to get impacted by economic slowdowns, global financial crises, and inflationary trends. The COVID-19 pandemic put additional pressure on their balance sheets and necessitated the intervention of the government along with loan restructuring efforts.

Reforms and Policy Interventions

Indian Public Sector Banks (PSBs) have witnessed major reforms in recent years aimed at enhancing their efficiency, deepening financial stability, and maximizing their contribution to economic growth. As their role is crucial to the Indian financial system, the successive governments and Reserve Bank of India (RBI) have made a number of policy interventions to mitigate issues like non-performing assets (NPAs), governance inefficiencies, and technology lags. The most important reforms and policies carried out to revamp and reinforce PSBs are presented below.

- **Bank Nationalization and Financial Inclusion Policies**

The nationalization of 14 large banks in 1969 and 6 additional banks in 1980 was a path-breaking reform to expand the outreach of banking services in rural and semi-urban regions. This action allowed PSBs to concentrate on financial inclusion, credit delivery to priority sectors, and rural growth. Successive financial inclusion schemes have been initiated over the years, including:

- **Pradhan Mantri Jan Dhan Yojana (PMJDY) (2014):** Focused on opening a bank account for every household, providing universal access to financial services.
- **Direct Benefit Transfer (DBT) System:** Facilitated subsidy transfer directly into the bank accounts of beneficiaries, minimizing leakage and enhancing transparency.

- **Recapitalization and Bank Mergers**

In order to consolidate the capital base of PSBs and their financial health, the government has initiated several recapitalization programs. The latest recapitalization program pumped in ₹2.11 lakh crore (2017) and ₹70,000 crore (2019) into ailing PSBs to augment their lending abilities.

Moreover, to achieve operational efficiency and cut unnecessary duplication, the government consolidated weak banks with healthy banks. Some of the main mergers include:

- Punjab National Bank (PNB) with Oriental Bank of Commerce and United Bank of India (2020)
- Canara Bank with Syndicate Bank (2020)
- Union Bank of India with Andhra Bank and Corporation Bank (2020)
- These mergers were meant to form larger, more powerful banks with superior operating efficiencies and enhanced risk management.

- **Insolvency and Bankruptcy Code (IBC) (2016)**

The launch of the Insolvency and Bankruptcy Code (IBC) was a watershed moment in resolving the problem of bad loans and NPAs in PSBs. It gave banks a formal framework to recover non-performing loans by filing for resolution proceedings against defaulters. The IBC has dramatically cut down the time taken to resolve cases and enhanced credit recovery rates.

- **Digital Transformation and Technology Adoption**

To upgrade banking operations and compete with foreign and private banks, PSBs are being motivated to implement digital banking solutions. The major initiatives are:

- **Core Banking Solutions (CBS):** Enabling smooth banking operations between branches.
- **Unified Payments Interface (UPI) and Digital Transactions:** Facilitating cashless payments and diminishing dependence on conventional banking.
- **Artificial Intelligence (AI) and Big Data Analytics:** Improving customer service, detecting fraud, and assessing credit risk.

- **Governance and Risk Management Reforms**

Governance and risk management reforms have been a major area of attention in recent times. Some of the prominent efforts include:

- **Banking Regulation (Amendment) Act, 2020:** Authorized RBI to regulate cooperative banks, providing enhanced governance and risk management.
- **EASE (Enhanced Access and Service Excellence) Framework:** Launched in 2018 to enhance PSBs' operational effectiveness, digital lending, customer services, and governance practices.

- **Privatisation and Disinvestment of PSBs**

For increasing efficiency and decreasing the burden on the government, privatization of PSBs has been under consideration. Plans for privatization of two public sector banks were announced by the government as a part of the strategic disinvestment policy. It is aimed at increasing competition and operational efficiency within the banking system.

Conclusion

Public Sector Banks (PSBs) have contributed significantly to Indian economic growth through financial inclusion, priority sector financing, and long-term funding for large-scale infrastructure projects. Ever since nationalization, PSBs have been central to mobilizing savings, ensuring credit availability in the unserved segments of society, and systemic stability during the downturn in the economy. Despite the growing competition from foreign and private banks, PSBs continue to be the pillars of India's financial system, catering to millions of people and businesses in urban and rural sectors.

Systemic interventions in the form of policy reforms and banking reforms have been introduced over the years to enhance the resilience and efficiency of PSBs. Financial health has been bolstered by the Insolvency and Bankruptcy Code (IBC), bank recapitalization initiatives, and mergers, whereas the EASE (Enhanced Access and Service Excellence) framework and digital banking efforts have brought modernity to their functioning. All these actions have contributed to PSBs overcoming issues of high NPAs, governance inefficiencies, and the requirement of technological upgradation.

But even after these reforms, a number of challenges remain. Political intervention, operational inefficiencies, regulatory hurdles, and competition from private sector players still affect the growth and efficiency of PSBs. To remain relevant and competitive, PSBs will have to implement technology-based banking solutions, enhance customer service, and upgrade risk management practices. Additionally, additional governance reforms, professional autonomy, and strategic efforts at privatization might be needed to enhance their long-term sustainability.

In the future, PSBs will remain an integral part of India's economic growth, more specifically in facilitating the government's financial inclusion programs, funding infrastructure projects, and extending credit to main economic sectors. With the proper policy environment, technology embrace, and governance adjustments, PSBs can increase their role in India's growth narrative and become a bulwark of financial solidity and economic advancement.

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