1.12 NARASIMHAM COMMITTEE RECOMMENDATIONS ON FINANCIAL REFORMS

1.12.1 Narasimham Committee Report 1991–98—Recommendations

In 1991, the Government of India appointed a committee under the Chairmanship of Shri M. Narasimham to examine all aspects relating to the structure, organization, functions and procedures of the financial system. The Deputy Governor, RBI (banking operations), Chairman of SBI, IDBI, ICICI, Shri Manu Shroff, Shri Y. H. Melegam, Shri Mrinal Datta Chaudhuri and the additional secretary (banking) were the members of the committee. The committee can be described as a committee on financial sector reforms. Since M. Narasimham also headed the second committee to review financial sector reforms and has submitted its report in April 1998, the first committee may be called Narasimham Committee-I and the 1998 committee be called Narasimham Committee-II.

1.12.2 Problems Identified by the Narasimham Committee

1.12.3 Narasimham Committee Report I—1991

The Narsimham Committee was set up in order to study the problems of the Indian financial system and to suggest some recommendations for improvement in the efficiency and productivity of the financial institution.

The committee has given the following major recommendations:

- **Reduction in the SLR and CRR:** The committee recommended the reduction of the higher proportion of the statutory liquidity ratio 'SLR' and the cash reserve ratio 'CRR'. Both of these ratios were very high at that time. The SLR then was 38.5 per cent and CRR was 15 per cent. This high amount of SLR and CRR meant locking the bank resources for government uses. As it was a hindrance in the productivity of the bank, the committee recommended their gradual reduction. SLR was recommended to reduce from 38.5 per cent to 25 per cent and CRR from 15 per cent to 3–5 per cent.
- **Phasing out directed credit programme:** In India, since nationalization, directed credit programmes were adopted by the government. The committee recommended phasing out of this programme. This programme compelled banks to earmark the financial resources for the needy and poor sectors at confessional rates of interest. It was reducing the profitability of banks and thus the committee recommended the stopping of this programme.
- **Interest rate determination:** The committee felt that the interest rates in India are regulated and controlled by the authorities. The determination of the interest rate should be on the grounds of market forces such as the demand for and the supply of fund. Hence, the committee recommended eliminating government controls on interest rate and phasing out the concessional interest rates for the priority sector.
- **Structural reorganizations of the banking sector:** The committee recommended that the actual numbers of public sector banks need to be reduced. Three to four big banks including SBI should be developed as international banks. Eight to ten banks having nationwide presence should concentrate on the national and universal banking services. Local banks should concentrate on region-specific banking. Regarding the RRBs (regional rural banks), it recommended that they should

focus on agriculture and rural financing. They recommended that the government should assure that henceforth there would not be any nationalization and that private and foreign banks should be allowed liberal entry in India.

- **Establishment of the ARF tribunal:** The proportion of bad debts and non-performing asset (NPA) of the public sector Banks and Development Financial Institute was very alarming in those days. The committee recommended the establishment of an asset reconstruction fund (ARF). This fund would take over the proportion of the bad and doubtful debts from the banks and financial institutions. It would help banks get rid of bad debts.
- **Removal of dual control:** In those days, banks were under the dual control of the Reserve Bank of India (RBI) and the Banking Division of the Ministry of Finance (Government of India). The committee recommended the stepping of this system. It considered and recommended that the RBI should be the only main agency to regulate banking in India.
- **Banking autonomy:** The committee recommended that the public sector banks should be free and autonomous. In order to pursue competitiveness and efficiency, banks must enjoy autonomy so that they can reform the work culture and banking technology upgradation will thus be easy.

Some of these recommendations were later accepted by the Government of India and became banking reforms.

Some of these recommendations were later accepted by the Government of India and became banking reforms.

1.12.4 Narasimham Committee Report II—1998

In 1998, the government appointed another committee under the chairmanship of Mr Narsimham. It is better known as the Banking Sector Committee. It was told to review the banking reform progress and design a programme for further strengthening the financial system of India. The committee focused on various areas such as capital adequacy, bank mergers, bank legislation and so on.

It submitted its report to the government in April 1998 with the following recommendations:

- **Strengthening banks in India:** The committee considered the stronger banking system in the context of the current account convertibility 'CAC'. It thought that Indian banks must be capable of handling problems regarding domestic liquidity and exchange rate management in the light of CAC. Thus, it recommended the merger of strong banks which would have a 'multiplier effect' on the industry.
- **Narrow banking:** In those days, many public sector banks were facing a problem of the non-performing assets (NPAs). Some of them had NPAs as high as 20 per cent of their assets. Thus, for successful rehabilitation of these banks it recommended a 'narrow banking concept' where weak banks would be allowed to place their funds only in short-term and risk-free assets.
- **Capital adequacy ratio:** In order to improve the inherent strength of the Indian banking system, the committee recommended that the government should raise the prescribed capital adequacy norms. This would further improve their absorption capacity also. Currently, the capital adequacy ratio for Indian banks is at 9 per cent.
- **Bank ownership:** As it had earlier mentioned the freedom for banks in its working and bank autonomy, it felt that the government control over the banks in the form of management and ownership and bank autonomy did not go hand in hand and thus it recommended a review of functions of boards and enabled them to adopt a professional corporate strategy.
- **Review of banking laws:** The committee considered that there was an urgent need for reviewing and amending main laws governing the Indian Banking Industry such as the RBI Act, Banking Regulation Act, State Bank of India Act, Bank Nationalisation Act and so on. This upgradation would bring them in line with the present needs of the banking sector in India.