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FY20 budget statement: Treatment of the financial sector

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Financial sector of a country encompasses a wide variety of institutions. Those include banks, capital market, insurance companies, nonbank financial institutions etc. This article focuses on the treatment of banks in the budget statement of the Finance Minister presented to the Jatiya Sangsad on June 13, 2019. The subject is of special importance in the present scenario of Bangladesh characterised by unabated increase of non-performing loans (NPLs) of the banking sector.

The budget statement notes that no mentionable reform initiative was taken in the banking sector from the beginning. There was no exit route for the loan recipient if he/she fails to repay the bank loan. It is claimed that exit for loan recipients through effective insolvency and bankruptcy laws has been arranged. I am not aware of effective implementation of these laws. The statement should have mentioned how many loan recipients have exited as a result of enforcement of insolvency and bankruptcy laws.

The statement rightly observes that banks in Bangladesh suffer from a maturity mismatch as they give long-term loans by collecting short-term deposits. Measures to remove such mismatch suggested in the statement are encouragement to instruments like Wage Earners' Bond, venture capital and a vibrant bond market. It should be mentioned here that these instruments are already in existence. There should have been an analysis of why these have failed to play expected role in investment financing and on that basis specific measures to remedy the situation should have been pointed out.

With regard to Banking Commission it is stated that there would be discussions with all concerned in this matter and the needful would be done. I have argued on many occasions that no Banking Commission is needed as the causes underlying the problems of the banking sector are well known and so are the solutions. A few comments on this will be offered later.

It is also noted in the statement that the government is thinking of a number of reforms in the banking sector. There is no indication of a time frame for transforming such thinking into action. Below are some comments relevant to suggested reforms.

First, authorised and paid-up capital of banks will be gradually increased. It is not clear as to how this step, if implemented, will make a dent in the volume of ever-increasing non-performing loans.

Second, Banking Company Act will be amended so that amalgamation, merger and absorption of banks can be legally processed, if required. There is no doubt that such steps are needed in the banking sector of Bangladesh with too many banks in a rather small economy. But, it is not clear as to whether the Government intends to enforce mandatory amalgamation, merger and absorption. If that is not done, I am doubtful if the banks will voluntarily take these steps.

Third, the statement mentions that stern measures will be taken against the wilful defaulters. However, there is no mention of the criteria for distinguishing wilful defaulters from unintentional ones. Many of the defaulters are politically connected or related in some way to the Sponsors/Directors of banks. In these circumstances banks are unlikely to declare any one as a wilful defaulter. Moreover, will it be necessary to amend any laws or promulgate new laws to ensure stern action? There is also no answer as to why stern actions were not taken in the past on the basis of existing laws.

Fourth, it is observed that the government has been working to bring down the interest rates of bank loans to single digits with a view to making our industries and businesses more competitive. There was an earlier decision that the interest rates on bank loans would not exceed 9.0 per cent. Available information indicates that this has not been implemented in practice.

In my opinion the banking system of Bangladesh is plagued with the following problems:

- There are too many banks in Bangladesh. The result is that the volume of business is rather small for each bank and they are not in a position to reap the benefits of economies of scale. Any business with a low volume will understandably try to charge higher unit price to reach desired revenue target. This is one explanation of why banks in Bangladesh charge high interest rates on loans.
- Governance in the banks leaves a lot to be desired. Loans are often given as a result of political influence. In many cases, loans are given to friends or relatives without paying due attention to the prospects of repayment on the basis of objective analysis of the loan proposals. In such cases, as the loan recipients fail to repay as per terms of the agreements, excessive generosity is shown in respect of recovery. The resultant high rate of default is also an important cause for high rate of interest. In the context of governance, it should also be mentioned that the recent decision to allow four members of a family on the Board and enhance their tenure runs counter to sound governance.
- There is an inordinate delay in disposal of loan-related cases. Thousands of cases have remained pending in the loan courts. A large chunk of defaulted loan cannot be recovered because of stay orders by higher courts.
- To an extent default is caused by the lack of adequate professional competence of bank staff responsible for evaluation of loan proposals. Here again the excessive number of banks aggravates the problem because banks are forced to engage in unhealthy competition to recruit professional staff from the limited pool.
- The imposition of 15 per cent tax on stock dividend distributed to the shareholders by any listed company also presages adverse consequences for financial soundness of banks as many of them are listed on the stock exchanges. The same comment applies with regard to imposition of 15 per cent additional tax on so much of retained earnings and reserves as it exceeds 50 per cent of the paid-up capital of a company.

It is crucially important to deal with the above problems. It is not necessary to set up a Bank Commission whose diagnosis of the banking sector problems is unlikely to be any different from those mentioned above. As regards solution to these problems, the first step needed is a firm political commitment to avoid political influence in either granting loans or recovering defaulted loans. The second step needed is to resolve quickly the cases stuck up in the legal system. The third step needed is for Bangladesh Bank to effectively implement sound governance principles in banks. There is no mention of these steps in the budget statement.

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