June 23, 2016 | Saurabh Chandra (http://www.infracircle.in/author/saurabhchandra/)
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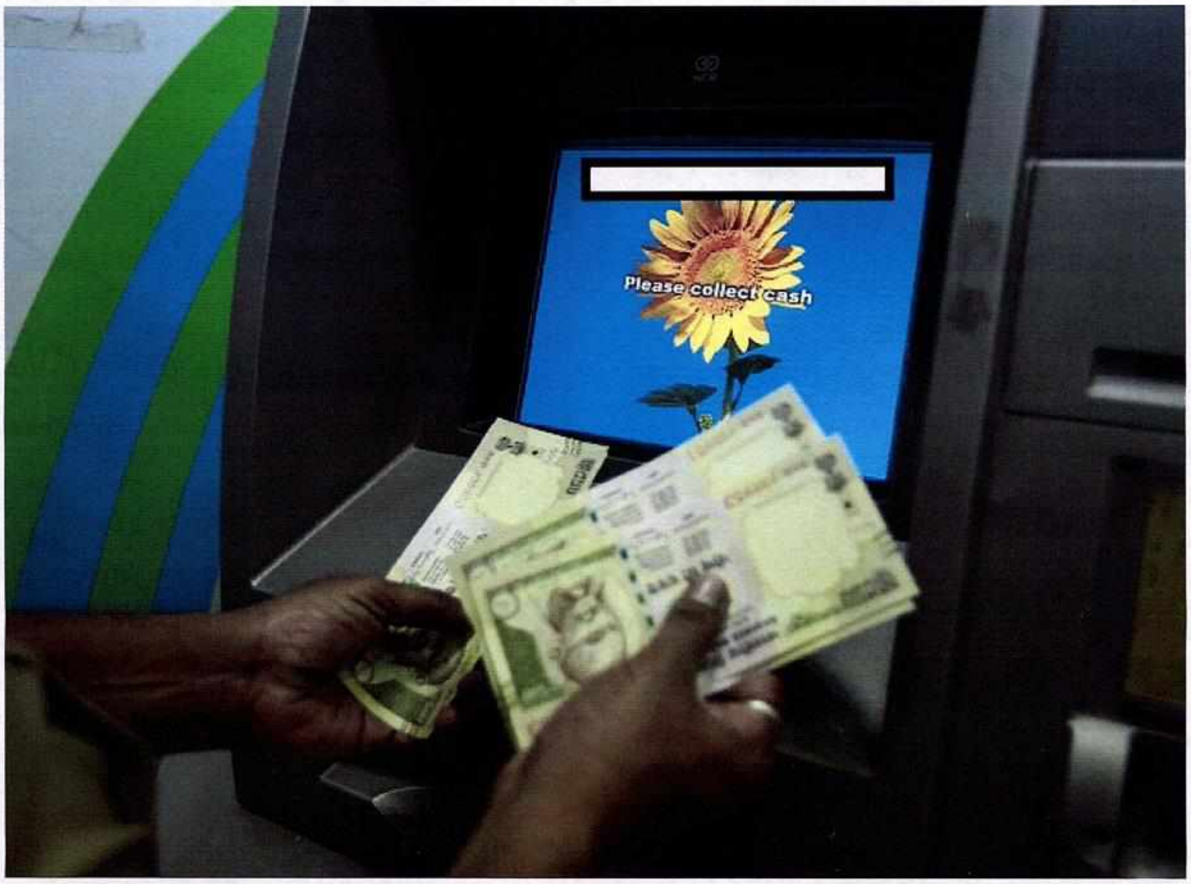
Why each one of us should be concerned about NPAs



Banks need to keep their interest spreads high to meet the ever-increasing losses. Photo by Reuters.

Round the clock, depositors are paying for the dent in the balance sheets of banks caused by loans whose repayment is jeopardized. Such loans are euphemistically called non-performing assets (NPAs).

Banks need to keep their interest spreads high to meet the ever-increasing losses. Resultantly, depositors make do with a lower interest rate on their deposits. Simultaneously, interest rates on loans remain high. So do the fees for various services.

Rising losses result in the need for re-capitalisation. For public sector banks, recapitalisation through equity infusion is largely from the public exchequer. The common man pays for it.

Dud loans were created by financing overvalued assets. The problem was compounded by restructuring. An ineffective recovery mechanism completed the vicious circle.

These loans are a big threat to the Indian growth story as investment is threatened. As per a recent World Bank report, India recorded a ten-year low in public-private investments for 2015. Besides increasing the infrastructure deficit, this has serious implications on job creation with the potential to disrupt social harmony.

Depositors bear this burden without a murmur of protest, an outcome of rational ignorance. Most are unaware that they are being shortchanged. Even when they are, there is little they can do against the might of banks and big defaulters. The cost of individual protest is high, the benefits low. They are dependent on the government and the Reserve Bank of India (RBI), the regulator, to protect their interests.

The government has set up debt recovery tribunals and asset reconstruction companies to effect recoveries of NPAs. RBI has also come out with a number of schemes to address this problem—corporate debt restructuring, joint lenders forum, 5/25 scheme and strategic debt restructuring. None of these measures and schemes has succeeded in arresting the northward trajectory of NPAs. The Scheme for Sustainable Structuring of Stressed Assets, the latest weapon in this repertoire, is unlikely to yield different results.

These measures allowed banks to kick the ball down the street. Loans were made evergreen by these 'pretend and extend' schemes. The remedy only worsened the disease, increased debt burden and made projects unviable. The outcome was a bubble, composed of 'unreceivable' receivables. NPAs are best tackled early when it is possible to save the assets created by loans. A change of management is usually a necessary condition. As the debt rises, the collateral security is often inadequate to cover cases of default. Today, it is common knowledge that only a small fraction of the outstanding amount of NPAs would ever be recovered. Banks will have to take severe haircuts. Bankers are reluctant to take this hard decision. This is born out of an apprehension that such write-offs could, at some time in the future, be a subject of an inquiry and\or investigation. The apprehension is real and stems out of provisions of the Prevention of Corruption Act, in particular section 13(1)(d)(iii) of the Act which terms obtaining any pecuniary advantage without any public interest for any person by the public servant as an act of criminal misconduct. The haircut can easily be termed as a pecuniary advantage for a loanee. How does one establish whether it is in public interest or not? No ready-reckoner is available. Hence the marked reluctance to act, bide time and maintain the status quo. Meanwhile the asset continues to deteriorate. And the prospect of recovery decreases.

There is a story—'The Flying Horse'—doing the rounds in the national capital, which aptly sums up this situation.

A whimsical king had a favourite horse. He wanted it to fly. So he made a proclamation that anybody who will make the horse fly in three years would get half his kingdom. Failure would invite capital punishment. After several months, one intrepid man agreed to take up this offer. Three months later nothing happened. After another three months, the horse still wouldn't fly. Well-wishers of the volunteer told him that he was foolish to risk his life for this impossible mission. His reply was revealing—who knows what will happen in three years? I may die, the king may go, horse may die or for all you know the horse may fly. But at least for three years, I will have a comfortable existence!

Poor Raghuram Rajan. This problem is not of his making. He had to deal with a dubious legacy. Despite his best intentions, the level of NPAs and wilful defaulters has only increased. Low recoveries, higher provisioning and hits on the bottomline would continue to be a persistent feature of the balance sheets of most of the banks. As he prepares to resume his academic career, it is a moot point whether he would have to deal with this intractable problem, if his predecessors had paid heed to Machiavelli's advice—"If you don't fight the wars you must, you will have to fight them tomorrow at a greater disadvantage."

Meanwhile, there will be no respite for depositors who will continue to bear the brunt of the losses being suffered by banks. Therein lies vindication of the theory of public choice.

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