

# Public Banks and the Burden of Private Infrastructure Investment

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It has been evident for some time now that the poor performance of important infrastructure projects and the associated financial fragility of these heavily leveraged large investments are among the most significant problems with the UPA government's economic strategy. Infrastructure projects, particularly in energy, mining and road development, have tended to be delayed and many have fallen well behind their scheduled dates of commissioning. Indeed, some have simply been halted midway, with no clear schedule for completion or even assurance that these will ever be completed.

These delays and lack of completion of projects are obviously wasteful of resources and bad news for the future growth and development potential of the country. They also have severely adverse implications for the financial institutions that have provided funds for such projects. Since development banking was effectively decimated in India in the period of neo-liberal economic reforms since 1991, and with a poorly developed bond market, the burden of such project financing has been disproportionately borne by public sector commercial banks that are ill-prepared for such lending and do not have the technical and other resources required to exercise due diligence on such lending.

Conventionally, commercial banks, which mobilise resources from the public through relatively small deposits that promise safety and liquidity, do not lend to projects involving lumpy, illiquid investments, with long gestation lags and relatively high risks. But the public commercial banks in India have been pushed over the past decade to provide more and more resources for such projects, such that infrastructure lending rose from only 3.6 per cent of bank credit to industry and 1.6 per cent of total bank credit in March 2000 to as much as 35 per cent of bank credit to industry and 13.4 per cent of total bank credit in March 2013. By contrast, private commercial banks are almost entirely absent from this activity.

The effects of this are now becoming clearly visible in the financial stress being experienced by the public banking system, which is being sought to be papered over by dealing with the rising Non-Performing Loan ratios through a combination of loan restructuring and capital infusion. But despite being so significant for the financial stability and future growth of the economy, the entire process is still very opaque and shrouded in some secrecy.

This is what makes a new Report from The Research Collective ("Down the Rabbit Hole: What the bankers aren't telling you - An analysis of lending practices adopted by banks to finance 'developmental' projects in India", February 2014) so significant. The Report provides detailed studies of six infrastructure projects – [Athena Demwe Lower Hydro Electric Power](#) (HEP), [GMR Kamalanga Energy Limited](#) (GKEL), [Sasan Ultra Mega Power Project](#), [Lavasa Hill City](#), Lafarge Surma and Krishnapatnam Ultra Mega Power Project (Coastal Andhra Power).

These cases are then situated in the context of the lending practices of the public commercial banks that have emerged as the primary financiers. The study reveals the unfortunate consequences of unaccountable lending; the serious implications of lack

of due diligence prior to sanctioning of loans to projects; the social and environmental issues impacting loan quality; and other weak links in the lending framework.

The first point that is worth noting is how secretive and opaque the lending practices of these banks remain, with respect to these huge advances that are effectively funded by citizens. The Right to Information Act was used to try and obtain information from the public sector banks that had been lending to these projects, but these 11 financial institutions denied access to basic information on their lending to specific projects. So an RTI application had to be filed in more general terms requesting general information on loans to companies, sector-wise distribution of loans, default on such loans, action taken on defaulters, credit risk management policies, procedures for sanctioning project finance loans and environmental and social guidelines for project finance.

It became clear that none of the 11 public sector banks have a policy to specifically deal with Project Finance. But in any case, very few people, including Government authorities, are privy to a bank's financial information or their guidelines. For the study, different banks provided answers to different questions and quoted different sections of the RTI Act to deny information. One bank refused to provide information on the amount of loans that are sanctioned annually to companies, while five of them claimed to not have 'centrally' available information on the volumes of loans provided to companies. Another claimed that it did not maintain separate records of loans to private sector and public sector units. If these are indeed the case, this is an alarming state of affairs that calls for much greater RBI monitoring and surveillance of the lending activities of these banks.

The next problem relates to the lack of adequate concern or even preparation for lending in terms of checking that all the required environmental and other clearances had been acquired by the project developers and all legal requirements for the project had been met. The study shows that banks have completely relegated the assessment of social and environmental impacts and risks of the projects they finance to the competence of agents appointed by project developers and government agencies.

It is common, particularly among industrialists, to blame "environmental activism" or protests by affected communities (including people displaced from homes, land and livelihood) for the delays and reversals of many infrastructure projects. However, as noted by the Report, the real fault lies in the initial lack of care and even downright illegality with which many of the projects were introduced and then sought to be pushed through. "Clearances granted by concerned authorities are being revoked due to large-scale violations or obfuscation of project information by project developers." (page 40)

In five out of the six cases, impacts from the project on human and environmental life were not assessed sufficiently. Also, in these five cases, communities have alleged that their consent was not sought through the mandatory consultation process. Four of these projects – GKEL, Lavasa Hill City, Lafarge Surma, and Sasan Power – are currently facing legal cases, filed by the affected communities, for wrongful acquisition of land. In all six cases, crucial information has been withheld by the project proponent in the Environmental Impact Assessment reports and in four out of the six cases, project proponents have deliberately provided false information in the

report to evade national procedures enacted to safeguard and protect the environment and conserve India's pristine forest regions.

It is widely perceived that the Ministry of Environment and Forests faces immense pressure to expedite the granting of environmental and forest clearances and often grants clearances to projects due to pressure from other Ministries, governments and industry bodies and lobbies. As a result, projects have been cleared without these legally mandated requirements.

This lack of due process has been critiqued by other official watchdog bodies. For example, a September 2013 [report by the Comptroller Auditor General of India \(CAG\) on Compensatory Afforestation in India](#) found "serious shortcomings in regulatory issues related to diversion of forest land, the abject failure to promote compensatory afforestation, the unauthorised diversion of forest land in the case of mining and the attendant violation of the environmental regime". The report also details "numerous instances of unauthorized renewal of leases, illegal mining, continuance of mining leases despite adverse comments in the monitoring reports, projects operating without environment clearances, unauthorized change of status of forest land and arbitrariness in decisions of forestry clearances". (quoted in report page 48)

This unseemly haste and lack of adequate concern for the environmental procedures is obviously illegal. But in any case it is really not a solution and ultimately proves to be counterproductive, as such projects then get challenged in the courts. Out of the six cases discussed in the report, five are facing civil, writ or arbitration cases and public interest litigations before courts and other authorities. Five of the projects are delayed, two of which have not even begun construction six years after initiation and three are still undergoing construction.

The study also highlights the shocking fact that the banks have continued to lend to projects even after the legal violations and adverse environmental and humanitarian impacts have been exposed. For example, when Lafarge Surma was taken to court by the Indian Government for violating a crucial national environmental legislation and defaulted on repayment of loan to international financial institutions due to a stop-work order from the Supreme Court of India, the banks unconditionally bailed out the project with short term loans to the company. Yet again, the infamous Lavasa project received bank credit without proper assessment of the social, environmental and financial risks. But even after the many legal violations came to light, banks approved another Rs 600 crore for work on the second phase of the Lavasa Hill City project!

For obvious reasons, any sustained delay to a project's progress is a risk on the loans sanctioned by banks. So there are clear links between socio-environmental issues and financial stress. The risk and the related stress are borne almost entirely by public sector banks, which have provided on average 75 per cent of the project expenditure for the projects in question, with the remaining portion of equity also typically tied up with public financial institutions that buy stakes in the project. The State Bank of India leads the pack. Between 2003-04 and 2010-11, its loans to the private sector grew over five times, while loans going to the power industry increased by 37 times and to the coal mining industry 16 times.

Contrast this indulgent attitude of the banks towards these companies with the hard line taken towards individual defaulters, who are sought to "named and shamed" into

repaying by publishing their names. But such generosity and sympathy toward large corporate customers obviously has an effect on banks' balance sheets. The resultant financial fragility is huge. According to the All India Bank Employees Association, in December 2013 total [Non-Performing Assets of banks reached Rs. 1,94,000 crore](#), with the public sector banks accounting for 85 per cent of this amount.

This is being sought to be covered up by successive rounds of “restructuring”, which allows banks to not classify the asset as a Non Performing Asset even in case of default. This provides temporary window dressing, but in most cases, it is only a matter of time before restructured loans become NPAs.

This is why the All India Bank Employee's Association (AIBEA) in December 2013 disclosed figures for bad loans, restructured loans, write offs and the names of top 50 corporate defaulters in public sector banks. The Association demanded that names of defaulters of over Rs 1 Crore be published; that wilful default of loan be made a criminal offence; that collusion and nexus be investigated; that recovery laws be amended to speed up recovery of bad loans; that stringent measures be taken to recover bad loans; and that corporate delinquency should not be incentivised either explicitly or implicitly.

It would be misplaced to blame the management of these banks alone for such a situation, although it is also true that the CBI has been examining the reluctance on the part of banks to declare bad accounts as frauds despite there being clear cut manifestations of this for its possible links to corruption. The larger problem is that the public sector banks have been more or less forced into these lending practices by the signals and incentives systems emanating from the central government.

As is becoming only too alarmingly obvious now, this strategy of pushing through private infrastructure projects without due regard to regulatory requirements and social and environmental norms is not only unjust and socially disruptive. It is also exposing the economy to huge financial risks and undermining the basis of public commercial banking in the country. It is important for the banking regulator – the Reserve Bank of India – to concern itself with these aspects, if it is really concerned with ensuring the stability and social goals of commercial banking in India.

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