Public Banks: Dressing up for the market*

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When the government presented its third supplementary demand for grants to the winter session of parliament, the list of expenditures included Rs. 80,000 crore for a first tranche investment in equity of the public sector banks to recapitalize them. This was a clear declaration that the government intended to go through with its plan to provide as much Rs. 1.35 lakh crore from its budget to recapitalize banks that are recording losses, as they recognize and provide for non-performing assets accumulated substantially from debt provided to a few large corporates. The recapitalisation plan announced in October 2017 promises to infuse Rs. 2.11 lakh crore of new equity into the PSBs, of whch Rs. 1,35,000 crore would be new money from the government's budget. Another Rs. 18,139 crore is the balance due under the Rs. 70,000 crore Indradhanush plan initiated in August 2015, and so also from the budget. The remaining Rs. 57,861 crore would have to be mobilised by the banks from the market through the issue of equity.

The government's decision to proceed with its plan is surprising given the state of its finances. In the past, the government was reticent to allocate too much of its funds for recapitalization because it would impact adversely on its fiscal consolidation efforts, aimed at bringing down the fiscal deficit to 3 per cent of GDP. When Budget 2017-18 was unveiled the Finance Ministry claimed that the fiscal deficit would be kept at 3.2 per cent of GDP, just one fifth of one percentage point higher than the governments medium term fiscal deficit target. This despite the signs of recession at the time the Budget was announced.

It now appears that the government is finding it difficult to keep its budgetary promise. According to the Controller General of Accounts, at the end of November 2017, the fiscal deficit on the government's budget for the first eight months of the financial year 2017-18 was at Rs. 6,12,105 crore already equal to 112 per cent of the budgetary target. In the corresponding period of 2016-17 that ratio was 85.8 per cent. Combine this with the fact that GDP growth in 2017-18 is expected to be significantly lower than projected in the budget, and the likelihood is that, without window-dressing, the fiscal deficit to GDP would be higher than projected by a wide margin.

The government's claim, in its supplementary demand for grants, that the Rs. 80,000 crore first-round financing being provided for recapitalisation through the issue of bonds for the purpose is an ingenious way of providing capital without upsetting fiscal deficit calculations, should fool no one. The idea seems to be to use the excess deposits with the banks to get them to buy the government issued bonds and for the government to use the money to acquire new equity in the banks. The argument is that since there is no real outflow or inflow of money, since the sums match, nothing is affected. That, however, is not even clever accounting. To start with, since the fiscal deficit is the excess of government expenditures (revenue and capital) over government revenues, the investment in public sector equity must be included in the deficit. Second, this amount cannot be excluded from the deficit figure on the grounds that it is being funded with "non-debt creating capital receipts", since debt is being used to finance it. And third, the fact that interest paid on the recapitalisation bonds and dividends received from the equity purchased would feature in future budgets is proof that debt is being used for a capital acquisition. So spurious claims to the contrary aside, the government's fiscal deficit containment plan is going awry. If the government were to stick to its earlier position that it cannot let recapitalisation upset its fiscal consolidation effort, then this is not the right time to go ahead with a large budget supported recapitalisation exercise.

Thus, given the circumstances in which the recapitalisation decision was announced and is being implemented, it is clear that the government was left with the no option. The pace of accumulation of NPAs and their current magnitudes are such that the banks are likely to violate important prudential norms and guidelines if the government does not intervene. As per the Reserve Bank of India's data, Gross Non-performing Assets (GNPAs) of all banks as on September 30 last year stood at Rs. 7,90,649 crore, with 87.25 per cent of the figure sitting on the books of the public sector banks. While in the first instance the write-offs of these sums are technical and subject to recovery, the evidence on recovery has not been comforting. The rate of recovery of NPAs of scheduled commercial banks through various channels (Lok Adalats, Debt Recovery Tribunals and the SARFAESI Act) had fallen from 22 per cent of amounts involved in cases referred to these channels and being considered by them at the end of March 2013 to 9.8 per cent by end-March 2017. Overall, the experience here has been disappointing. Not only has total NPA reduction been flat between 2014-15 (Rs. 1,270 billion) and 2015-16 (Rs. 1,280 billion) when the sum of declared NPAs was rising, but much of this reduction has been the result of compromises or write-offs, which yield the bank little or nothing. NPA reduction is reported under three heads (actual recoveries, 'upgradation' or transformation of NPAs into paying assets, and compromises/write-offs). Write–offs involve a complete loss for the banks. According to Finance Ministry figures the share of write-offs in the NPA reduction of the public sector banks rose from an already high 41 per cent in 2014-15 to 46 per cent in 2015-16. In the event, according to Finance Ministry figures, PSU banks have written off a total of Rs 2.46 lakh crore worth of loans over the five years 2012-13 to 2016-17. The ratio of declared profits to write-offs has fallen sharply. In 2012-13, PSU banks wrote off Rs 27,231 crore while declaring combined net profit of Rs 45,849 crore. The corresponding figures for 2016-17 were Rs 81,683 crore and Rs 474 crore (The Indian Express, August 7, 2017).

Part of the reason for this is that the government has been encouraging banks to be lenient when pursuing defaulting firms, unless they are wilful defaulters. Thus, the Finance Ministry's Economic Survey 2016-17 argued : "Cash flows in the large stressed companies have been deteriorating over the past few years, to the point where debt reductions of more than 50 percent will often be needed to restore viability. The only alternative would be to convert debt to equity, take over the companies, and then sell them at a loss." The point implicitly being made here is that it is necessary to help get companies back on their feet even at the expense of bank balance sheets. The Finance Ministry's claim was that this is necessary because the companies cannot share any blame for their current position: "Without doubt, there are cases where debt repayment problems have been caused by diversion of funds. But the vast bulk of the problem has been caused by unexpected changes in the economic environment: timetables, exchange rates, and growth rate assumptions going wrong," the Survey argued.

If corporate borrowers are let off the hook and losses of the banks recapitalised with resources from the budget, then private losses are clearly being socialised, since their burden is being transferred to those paying direct and indirect taxes today or in the future. This has been underway for some time now. Between 2000-01 and 2014-15, budgetary allocations for recapitalisation of banks totalled Rs. 81,200 crore. Much of this was provided for in recent years, with as much as Rs. 58,600 crore (or around 72 per cent of the total) announced during just four consecutive years ending 2013-14. However, the government seemed to have lost the appetite for such recapitalisation, because of its commitment for fiscal consolidation. Even when it was seen as unavoidable, allocations from the budget for the purpose were short of what was promised, and what was promised was short of what is required. In 2014-15, while Rs. 11,200 crore was allocated for the purpose in the budget, actual capital infusion into public sector banks was just Rs. 6,990 crore. Then in 2015-16 there was a revival, despite the initial reduction of even the budgetary allocation for the purpose to Rs. 7,940 crore. In the course of the year the government announced a four-year 'Indradanush' plan under which the public sector banks (PSBs) would be provided with new capital worth Rs. 70,000 crore, with Rs.25,000 crore being disbursed that financial year and the next, and Rs. 10,000 crore in each of the two subsequent years. In its most recent avatar the recapitalisation exercise is the Rs. 2.11 lakh crore plan announced in October 2017. This revival of interest in large scale recapitalisation can only be because the government had no options given the crisis in the public banking industry.

If bad debt cannot be recovered the only option is mobilising new capital. If that does not come from the government it can only come from private investors offered new equity. But sale of equity is not easily done at reasonable prices when the books of banks are burdened with NPAs. So clearly, unable to sell equity now, the government is cleaning out the books of the banks. What is not being discussed, however, is the supporting policies required outside the banking sector needed to ensure that banks can, after recapitalisation, keep business going without being exposed to defaulters. If that possibility arises, with cleaner books now, they would be ready to go to market to recapitalise themselves by finding private shareholders. But that may require allowing private shareholding in excess of 50 per cent. As a former Governor of the RBI, D. Subbarao, argued echoing a common establishment view, "fiscal constraints pose significant challenges" to the effort to re-capitalise banks and ensure they meet Basel III norms, but bringing government holding to below 51 per cent can resolve the problem. Budget supported recapitalisation is not an effort to prevent privatisation of public banks. It is to dress them up before taking them to market.

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