Banks and Non-performing Assets

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What exactly constitutes a non-performing asset (NPA) of a bank is not easy to determine. Since banks tend to roll over credit to borrowers, whether the request for such a roll over arises in the normal course of business or owing to a fundamental inability to pay back the loan, is difficult to decide. The tendency of late therefore has been to see NPAs as an extreme case of a wider category called "stressed assets" which are defined according to certain criteria.

The problem of NPAs has arisen in a serious form in recent times because of the change in the nature of banking in the country. In the pre-liberalization days, we had essentially commercial banks which gave short-term loans to meet the working capital needs of borrowers against inventories held by them. Longer term credit came from a host of specialized financial institutions, the IDBI, IFCI and SFCs, which charged low interest rates (often even negative in real terms), lower than on short-term credit, as a means of encouraging investment. Under this system, the inventories were the collateral for commercial banks and inability to repay meant that banks could seize these inventories. This system no doubt had its own problems, such as obtaining credit from multiple sources for the same inventories, and inaccurate and haphazard evaluation of inventories by banks. But the problem of NPAs was restricted in principle.

After liberalization however this system has changed, with the specialized financial institutions dwindling in significance (many of them like the IDBI have become banks), and commercial banks also giving longer-term loans. Since long-term investments may or may not become viable, such loans run the risk of becoming non-performing assets of banks. Not that NPAs arise exclusively for this reason, but the problem of NPAs now surfaces as a structural accompaniment of this change.

There are three basic reasons why NPAs arise: one, just mentioned, is that investment projects may not become viable in the manner originally visualized for a host of unforeseen but legitimate reasons. The second is when investment projects are not viable to start with, but banks nonetheless are either cajoled into giving loans by the government, or swept away into doing so by euphoria, rather than careful evaluation of prospects, because of asset price bubbles and such like. When the basic unviability of the project becomes apparent in such cases, the loan becomes a non-performing asset. The third is when the borrower, typically a large financial house, uses its clout and political influence to obtain loans which it has no intention of paying back, at least in full, and which in other words constitute pure "loot".

Needless to say, such "loot" is easier to arrange from public sector banks, because political influence counts in their case, compared to private banks which naturally are more hard-headed in the matter (which incidentally is an argument not for privatizing public sector banks, but for democratic control over their functioning, for example through greater parliament-supervised scrutiny over their lending policy, that frees them from arbitrary government interference).

From the earliest days of bank nationalization whose objective among others was to make institutional credit available to the agricultural sector, an impression has been

sought to be created by spokesmen of monopoly capital that the main reason for NPAs lies in the inability of peasants to repay bank loans. The absurdity of this claim has been exposed by the list of defaulting borrowers which has been brought out periodically by bank employees but never by the government, where the largest defaulters have been shown to be the corporate borrowers (often the very same individuals who shout the most about public sector banks lending irresponsibly to undeserving borrowers).

But any default by borrowers from the agricultural sector falls typically into the first category mentioned above (where the cause of default is genuine); and, what is more, the reason behind such genuine, as opposed to willful, default is structural, having to do not with the borrowers themselves but with the macroeconomic arrangements over which they have no control.

It has been well-known for centuries that agricultural prices, especially cash crop prices, display large fluctuations, making their production an extremely risky business. To insulate producers from such risk so that they can continue their operations, and expand them through undertaking investment, which is necessary for society, the government had put in place a mechanism for providing assured remunerative prices, in the food crops through the CACP-FCI route, and in cash crops through the marketing operations of the various commodity boards. Under neo-liberalism the marketing functions of these commodity boards have ceased to exist altogether; and Doha-round negotiations are casting a shadow even on the CACP-FCI arrangement.

Under neo-liberalism, not only has institutional credit to peasant agriculture dried up anyway, but the repayment by peasants of even such institutional credit that comes their way has become problematical because of the removal of price support. Those who oppose debt-relief to peasants on the grounds that this creates a problem of "moral hazard" (i.e. encourages future default) fail to see that such periodic default is built into the logic of a neo-liberal economy that entails the withdrawal of price-support for peasant agriculture. Hence the solution to the problem of peasant debt-default lies in combining debt-relief with price-support.

But peasant debt-default is by no means the serious issue before the banking system. The magnitude of NPAs as already mentioned is difficult to determine, but knowledgeable sources put it at around Rs.8 lakh crores at present. The corporate share in this is estimated roughly to be around 75 percent. A part of this corporate default is because under government pressure banks had given large loans for so-called "infrastructure development", to projects of dubious economic viability (often camouflaged real estate projects). But a very substantial part consists of sheer "loot" where large corporate borrowers have simply used the loans for lining their pockets. The share of such "loot" in the total NPAs to the corporate sector is of course difficult to ascertain, but knowledgeable sources again guess this share to be around 75 percent. These "guestimates" therefore would suggest that around 56.25 percent (75 percent of 75 percent) of the total NPAs of banks arise owing to the sheer siphoning of bank funds by corporate entities for lining their own pockets.

It is in this context that the recent bank recapitalization by the BJP government has to be assessed. There are two absolutely obvious problems with this measure. First, it is not accompanied by any move for recovering the loans from these corporate

defaulters. The “experts” who had so loudly talked of “moral hazard” when even limited debt-relief was provide to the farmers, are remarkably silent when bank recapitalization is announced without any accompanying attempt to recover loans from corporate defaulters.

Secondly, the government has already announced that the resources for such recapitalization would come from the budget. What this amounts to is a gigantic assault on the working people. Now, MGNREGS outlay will be cut (it is already limited relative to requirements as is evident from the huge non-payment of wages), ICDS outlay will be cut, i.e. even the limited welfare expenditures being undertaken at present will be further pruned, in order to compensate the banking system for the “loot” perpetrated by the corporate-financial oligarchy.

What is more, using fiscal resources for recapitalization is not even necessary. Suppose the government just used money printed by the Reserve Bank, against government bonds especially created for the purpose, to recapitalize banks, and this money simply remained parked with the RBI except to the extent that banks required it for making loans (i.e. when the demand for credit exceeded what they could provide from the resources already available to them), then there would be no reason to expect any serious problems. In case there were any inflationary pressures, then the usual mix of policies in the government’s armoury, from monetary policy to restrict speculation to supply management for easing specific shortages, could be resorted to for countering such pressures.

The real reason the government is using fiscal resources for recapitalizing banks is because international finance capital wants it that way: any recapitalization by newly-printed money will be counted as a fiscal deficit, which will mean that the government will no longer be in the good books of globalized finance (with a downgrade of its credit-rating). In short, funding corporate “loot” at the expense of welfare expenditure for the people is the demand of globalized finance.

This government professes to be against black money and cronyism. But if it was at all serious, then it should have taken at least three obvious measures: first, making public the list of large defaulters; second, undertaking an independent inquiry, at least for large defaults, to determine whether a case of default is willful or because of factors beyond the borrower’s control; and, third, amending laws to ensure that where there was clear evidence of willful default on the part of corporate borrowers, “limited liability” provisions were not applied in the case of the promoters of the company involved, i.e. that their other assets made liable to seizure as penalty for willful default. But if the government did all these, then it would forfeit both corporate funding and corporate media backing, both of which have been so essential for its viability.