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Provisioning for more

Public sector banks must be open about troubled lending

It may seem counter-intuitive, but lenders dislike a trend of rising interest rates almost as much as borrowers. First of all, rising rates reduce the mark-to-market value of any loans advanced previously at lower rates. They also choke off credit offtake volume. In a competitive lending environment, lenders are also compelled to hike their deposit rates, leading to pressure on spreads. Finally and perhaps most critically, rising interest costs make it difficult for debtors to generate enough profits to service outstanding debt.

India's banking sector, especially the public sector banks (PSBs), has spent the last three years struggling to cope with all these issues. The Reserve Bank of India (RBI) has maintained a hawkish monetary stance since March 2010. The central bank has hiked the repurchase (repo) rate by a cumulative 375 basis points to eight per cent in the past 30 months and maintained correspondingly high reverse repo of seven per cent and a cash reserve ratio (CRR) of 4.75 per cent. The impact on growth and banking asset quality has been quite severe. Non-performing assets (NPAs) have swelled as a proportion of advances. While private sector banks have managed to hold the line in terms of NPAs, the PSBs have been badly affected. Most PSBs have seen their gross NPAs as a percentage of advances increase by anywhere between 50 and 150 basis points in the first quarter of 2012-13 over the fourth quarter of 2011-12. Net NPAs also show corresponding increases, and a trend of under-provisioning is evident. The majority of PSBs have cut their respective provision coverage ratios in 2011-12 and again in Q1 of 2012-13 in order to maintain an illusion of profitability. In addition to this, debt-restructuring requests have shot up. Restructured assets (which don't count as NPAs) as a percentage of advances are reckoned to be somewhere around 5.5 per cent for the public sector bank universe in the first quarter of 2012-13. This is substantially larger than in Q4, 2011-12 (4.7 per cent) and even more compared to Q1, 2011-12 (3.9 per cent). Restructured debt is riskier — about 15 per cent of restructured loans eventually go sour. Restructured debt also fetches lower returns since banks cut their interest rates in the hopes of rescuing the principal.

The RBI is understandably worried. The Mahapatra Committee, which it appointed to examine the issue, has recommended that provisioning for restructured assets be raised to five per cent from the current two per cent. Public sector bank managements may not like the idea as this could drive their balance sheets into the red if it was adopted. However, the proposal for provisioning needs to be endorsed as it would give everybody a clear idea of the dimensions of the problem. This might also make it easier to structure bailouts as and when they become necessary. In practice, market valuations suggest that investors don't believe the official numbers anyhow. The PSB segment trades at single-digit PE ratios, while their private sector competitors receive average valuations that are thrice as high. In fact, most PSB shares are available at fractions of their book value, which is probably even more telling. There are no signs the RBI is prepared to lower rates yet, giving all the affected parties a shot at turning things around. The capital adequacy norms under BASEL-III demand the raising of another round of Tier I capital, which will be difficult in the current depressed environment and because of the stress it would cause for the Centre's finances. The sooner the PSBs bite the bullet and the Union government as their majority shareholder provides the necessary resources, the better it will be for India's financial sector.

Time to acquire

Delaying land Bill will hit growth

The Land Acquisition Bill – now renamed the Right to Fair Compensation, Resettlement, Rehabilitation and Transparency in Land Acquisition Bill, perhaps because the United Progressive Alliance really likes to call things "rights" – has been further delayed. After two successive attempts to pass it through the Cabinet failed this week, it has been referred to a group of ministers so that it can be gone through "clause by clause". This is partly because the Bill has been changed considerably following input from the standing committee, and partly because several ministers have felt that its provisions will greatly hamper growth, industrialisation and urbanisation.

Certainly, the Bill is important, and the Centre must get it right. And there continue to be many problematic provisions, such as the arbitrarily set benchmark that prices for acquisition should be twice the market rate in urban areas, and four times the market rate in rural areas. Yet many troublesome criteria have been watered down. Multi-cropped land can now be acquired for infrastructure purposes, for example, which is an important change; the restriction on its acquisition for other "public purposes" is misguided, but the provision will not bite as much as it did earlier. States have been given leeway in the exact multiple of market price they pay farmers, the threshold limit before which resettlement and rehabilitation provisions will be invoked, and the amount of double-cropped land they can acquire.

Yet several Union ministers are reportedly unhappy. The urban development minister worries that town planning will be hit because social impact surveys cannot be prepared, and the finances of development authorities are too weak to pay compensation. The roads minister is worried that highway building will be hit, though it is specifically exempted from the Bill's ambit. The commerce minister is concerned that special economic zones won't be covered by the Bill. Most of these objections seem weak, as compared to the Bill's impact — and they are definitely insufficiently thought through. The relevant ministries would no doubt say that's exactly why another clause-by-clause reading is needed. But the question remains: the Bill has been pending for years, and has been considerably altered in that time. Surely the ministries have had sufficient time to present their case by now? Some of the more fevered complaints about the Bill suggest that it would hit growth hard. Even a large increase in the cost of land, however, might not have a big impact on total project costs: the rural development ministry says it will be at most three per cent of project costs. More to the point, the constraint on growth comes not from the price of land, but from the supply of land — and the supply effect of a streamlined acquisition process would be more than enough to offset any additional costs in terms of the effect on growth. The government has dilly-dallied long enough. It is time to clear the land Bill, and get acquisition moving again.

ILLUSTRATION BY BINAY SINHA

Favouring foreigners in finance

Forcing banks to hold govt assets while opening up to foreign capital flows winds up penalising small Indian savers, says **Arvind Subramanian**

Can nationalism be harnessed to promote sound economic policies? That seems an odd question to raise at a time when Indian policy makers have rightly been taken to task in recent months for the heavy-handed and arbitrary treatment of foreign investors. But, yes, in the financial sector, policies penalise or tax Indians while treating foreigners more favourably. Even more worryingly, all the signs are that this wedge may even diverge to the advantage of foreigners and to the detriment of the economy.

One of the two policies in question is the statutory liquidity ratio (SLR), a seemingly arcane measure under which Indian banks are forced to hold a hefty portion (23 per cent) of their assets in government bonds. This policy would rank high among the bad relics of pre-reform India. The second is the openness to foreign capital, especially foreign financial flows. Consider each.

The SLR reflects what economists call "financial repression" and, at least in today's environment, exacts large costs on the economy. It taxes savings, makes the financial sector less efficient and reduces the availability of resources for the private sector. Just a few days ago, figures from the Reserve Bank of India (RBI) showed a decline in savings through the financial system from 12 per cent of GDP to eight per cent because higher inflation – another form of financial repression – had reduced real deposit rates.

But it exists for a simple reason, which is also one of the policy's biggest economic costs: to sustain the profligacy of India's political class. India runs large fiscal deficits and if savers were not forced to finance them, interest rates would go up, forcing politicians to own up to their rapacity and populism.

It would be desirable to gradually eliminate or significantly reduce SLR. Asking the government to eliminate SLR would be akin to asking a binge drinker to close down the booze shop that he himself owns. Credible reductions in SLR can only be achieved if fiscal consolidation is feasible. So, when Vijay Kelkar, chairman of the 13th Finance Commission, presents ideas to the finance minister on fiscal consolidation, he should call for an explicit link between the two.

The second policy in question relates to capital account opening. Unable to implement "good" reforms such as reducing subsidies, implementing the goods and services tax , and establishing rules on land acquisition, keen to redress its reputation of being harsh on foreign investors, and desperate to restore its pro-reform credentials, this government and the RBI have been opening the economy to foreign financial flows.

Whatever the merits of this policy in normal circumstances (explored with my colleagues Olivier Jeanne and John Williamson in our recent book, *Who Needs to Open the Capital Account*), it is less likely to be good policy under current economic circumstances. Indeed, a combination of high inflation, high fiscal deficits and widening external imbalances is just about the perfect time *not* to embrace foreign capital inflows. The flows that are attracted will be speculative, they will render the exchange rate uncompetitive affecting manufacturing exports, and when the inevitable sudden stop materialises financial chaos will ensue. Unless India is somehow unique, that is the evidence from recent history.

Going forward, though, it is likely that one bad policy – the SLR – is unlikely to be eliminated while the other – capital account opening – is likely to be pursued vigorously. Interestingly, it is the liberals in policy-making that are likely to persist with this course of action. Their not unreasonable justification will be that SLR reductions are off the table because the underlying fiscal consolidation is politically infeasible and that that should not come in the way of pursuing economic opening. Unfortunately, they remain unconvinced that capital account opening today is bad policy, especially if SLR cannot be eliminated, and that it might be better to maintain the *status quo*.

So how should the liberals be persuaded? The time seems ripe for playing the populist, even jingoistic, card to head off a worsening of the policy stance. That card amounts to making the link between the two policies and contrasting their relative impact on Indians and foreigners.

Go back to SLR. Although, it is a policy that immediately impacts on banks, its real economic effect is to deprive Indian savers – those who deposit their money in banks – of the opportunity to invest in the full range of private sector assets, effectively lowering the return that they make on their savings. The counter that savers have the choice not to put their money in banks but to invest it directly in private sector assets ignores the crucial fact that banks are perhaps the only provider of financial services, including as a savings vehicle, for a vast majority of not-so-financially-sophisticated Indians.

At the same time, consider the implications of an open capital account. Foreign savers/investors can have relatively unencumbered access to a wide range of Indian private sector assets. To be sure, foreigners cannot invest fully in Indian government assets and they cannot acquire certain claims on Indian private sector assets (for example, corporate bonds). But these relatively less important exceptions apart, their choice is less limited than that of the poor Indian saver, a quarter of whose savings cannot legally be invested in remunerative Indian private sector assets.

In other words, the combination of the financial repression inherent in SLR and a relatively open capital account is discriminatory: unfair to India's savers and advantageous to foreign savers. And given that India's savers are on average much poorer than the average foreign investor, Indian policies seem bizarrely inequitable.

The response of the liberals will be: what better way to rectify this inequity than by completely liberalising the capital account so that domestic savers can enjoy full access to foreign assets (and domestic investors can have access to cheaper foreign borrowing)? In other words, having penalised savers domestically through SLR, the best way to overcome that is to provide unrestricted choice internationally.

Conceptually, this is a fair point. But in practice, for the very reasons that banks are important savings vehicles, most Indian savers are unlikely to be capable of benefitting from the expanded choice. More importantly, as discussed above, the fact of high deficits and macroeconomic vulnerability makes these unpropitious times for further opening to capital flows.

So, the next time we see a further bout of capital opening with little being done to correct the fiscal imbalances and eliminating the SLR, we should be clear about the impact, if not the intent, of these policies: the Indian government favouring rich foreigners while penalising poor Indian savers. The populists can unite in this cause against the economic liberals. For a change, they could be on the right side of the economic argument.

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Summer of corporate discontent

SWOT

KANIKA DATTA

Something must be truly rotten in the state of India if the business community is driven to criticising the government in the full glare of publicity and in strong terms.

This year alone has seen a unique summer of openly voiced discontent. First, it was Azim Premji, Wipro's highly respected promoter, who questioned the government's inability to accelerate economic growth. "India is functioning without a leader," he told an analysts' conference in June — ironically, on the same day Standard & Poor's downgraded the outlook on India.

Around the same time, N R Narayana Murthy, Infosys' chairman emeritus and *eminence grise* of India's glitzy new economy, voiced some concern about the ennui the UPA government demonstrated over anti-corruption legislation. Then earlier this month, he told a TV news channel the government needed to be more "pro-active" in creating more jobs, attracting foreign direct investment and so on and so forth.

In July came a bluntly worded observation from Larsen & Toubro (L&T) in a press release announcing its results. In the curious banker/corporate-speak that analysts tend to adopt, the release somberly warned that policy delays and high interest rates have "moderated" growth prospects in the domestic economy. It is worth wondering whether L&T's forthright Chairman A M Naik would have been even more pithy had he been asked a direct question.

Now, earlier this week, you have HDFC Chairman Deepak Parekh providing robust critiques of everything from banking, stock market and insurance industry regulation at an investors' meet. He followed this up by suggesting, in an interview to a TV channel yesterday, that India would be downgraded to junk status if the policy paralysis continues.

Individually, these are reputed representatives of the corporate community, with credentials impeccable enough for their observations to carry weight. Several of them sit, or have sat, on a variety of panels and committees advising the government on policy, so they also speak from positions as "outsider-insiders", so to speak.

As the major job creator of the past decade, the private sector is certainly in a position to demand reform more vociferously

Taken collectively, however, this behaviour is so aberrant that the government might do well to take note of it. By and large, executives operating in India – whether rich and powerful, middle-level, Indian or foreign – have made it a habit to be uber-ultra-cautious about how they criticise the government on the record.

That is, if they dare to do so at all. The retired scion of a corporate house appointed to a quasi-government job once reacted thus when asked how he liked working with government. "No comment," he smirked — and then quickly added, "but that's off the record." Then followed an anxious phone call to confirm that this quite harmless comment would stay off the record in the published interview.

Business Standard's post-Budget juries comprising leading businessmen rarely give low ratings even to the most horrendous of Budgets (including Pranab Mukherjee's last one), despite knowing that they could impact business adversely. This is often widely at variance with what they say off the record, as any journalist will testify.

Of course, this year's criticisms hardly amount to a tidal wave of change — they're more like the preliminary line of breakers on the shoreline. Still, this should be considered a healthy development for two related reasons. One, it's a sign that the corporate community is developing a stronger sense of self-confidence as a constituency representing the best of India's global reputation. As the major job creator of the past decade, the private sector is certainly in a position to demand reform more vociferously, especially change that will maximise opportunities for growth. This is a great leap forward from the business community's initial stance as complainant (incredibly, against global competition) and perpetual mendicant for this or that tax break or policy change (the profit-rich IT industry's enthusiasm for perpetual tax holidays being a case in point.)

Two, businessmen have been loath to criticise the government publicly in the past because they feared the fell retaliatory hands of its enforcement and investigative agencies. This remains a threat to be sure, especially as simplified laws reduce the rent-extracting opportunities for government servants. But the overall political outlook has changed. Older businessmen and entrepreneurs will recall the raid raj of the seventies and eighties and V P Singh's infamous blacklist of prominent corporate tax dodgers. Today even the most thin-skinned of governments are unlikely to acquire such tendencies. So maybe more businessmen should be as intrepid as the Premjis, Narayana Murthys and Parekhs to speak out — and as reputable too.

A gift of wings

BOOK REVIEW

KARTIK SHANKER

The Bombay Natural History Society (BNHS), founded in 1883, and one of the oldest environmental non-governmental organisations in India, can well consider itself the spiritual home of ornithological research and conservation in India. From Salim Ali and Humayun Abdulali to, more recently, the late Ravi Sankaran, the BNHS has produced and nurtured many ornithologists in this country. Asad Rahmani, who is part of this great tradition, offers another, in a long line of bird books from this organisation, detailed account of birds in India.

Threatened Birds of India: Their Conservation Requirements is a near-1,000-page volume dedicated to 150 species of birds in India, classified as "critically endangered", "endangered", "vulnerable" and "near-threatened" in the IUCN Red List. Each species' account is remarkably detailed and contains information on field characters, distribution, ecology, threats, conservation and recommendations. Each account is accompanied by photographs of the species and, in many cases, of the habitat.

The distribution maps are outstanding. There are polygon maps that show the general distribution of the species, maps showing verifiable site records and a combination of the two. These maps provide an invaluable account of the known distribution or occurrence of these threatened species and can serve as a baseline for the future. Mr Rahmani credits his colleagues Mohit Kalra and Noor Khan with producing maps for all the species.

There are numerous boxes with notes on taxonomy, on behaviour (often with an image and quotes from well-known ornithologists), and on the etymology of the Latin name. Many chapters also provide historical information about the species or their conservation status. In addition, for several species, biologists or researchers working on those taxa are listed as species experts (sometimes with a photograph), which can be immensely useful for other ornithologists who want to pursue research on those species. Taken together, these little elements make each account entertaining and informative.

The book begins with an introduction by Mr Rahmani. He describes how the idea originated from BirdLife International's two-volume *Threatened Birds of Asia*. A large number of contributors and data sources were used in compiling this volume, and the author carefully documents how each species' account was put together.

The chapters have been vetted by ornithologists and researchers, duly acknowledged, which lends credibility to the book. Additional notes follow on the compilation of species lists and the treatment of taxonomic uncertainty.

The introduction also has some nice informative tables, including one on changes in the IUCN threat status of over 200 species of birds in India, from 1988 to 2011. Two other tables include the list of bird species in the Indian Wildlife Protection Act, and the list of birds for which India serves as the guardian country. The introduction ends with a series of recommendations and a shopping list of essential references for birdwatchers and ornithologists.

This section is followed by a series of contributed articles on bird conservation in India. There is an account of trade in threatened birds, the status of pesticide contamination in birds, dams and consequent threats in the Brahmaputra floodplains, bird conservation in the Andaman and Nicobar Islands and the Terai grasslands, and the taxonomy of laughing thrushes of the Western Ghats. Although an odd assortment of articles, they are mostly well written; the one on trade is particularly comprehensive.

For Dr Rahmani, as everyone in the wildlife and ecology world knows him, this is clearly a labour of love. He joined the BNHS in 1980 and, apart from a brief stint in Aligarh Muslim University in the 1990s, has served there for at least 30 years, the last 15 as its director. He has also served as the editor of its journal, and of its more popular publications, *Hornbill* and *Mistnet*.

This experience has served him well in putting together a compilation with inputs from a large number of birders from around the country. Mr Rahmani is also well known for his balanced views on conservation, and on the need to engage people in conservation work. This comes from the knowledge that threatened birds are found across a wide variety of landscape, not just protected areas. This comes through beautifully in the wide array of habitats depicted in the book.

Though this volume, priced at ₹3,000, is likely to cater to a specialised audience in terms of personal ownership, the information is sufficiently general yet well-written, and so it should be made accessible to students, young birdwatchers and aspiring ornithologists. More than any other group, birds have benefited from a cadre of amateurs, and this book will no doubt help engage and expand that community. Given that some of the core information in the book (species distribution maps, conservation status, etc) is likely to change rapidly, it would be useful to have an online version that can be updated periodically.

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THREATENED BIRDS OF INDIA: THEIR CONSERVATION REQUIREMENTS
Asad Rahmani
870 pages; ₹3,000