Rehab for the balance sheet
A centralised Public Sector Asset Rehabilitation Agency (PARA) could help over-leveraged corporates and bad-loan encumbered banks

JOSHUA FELMAN, RANGEET GHOSHI, SYED NAZUBA NOOVI AND ARVIND SUBRAMANIAN

EVEN WHEN THE global financial crisis, India has been trying to grapple with its twin balance-sheet (TBS) problem—over-leveraged corporates and the bad-loan encumbered banks. But a decisive resolution has proved elusive, and the problem has continued to festify. Perhaps it is time to consider a more systematic approach. In his budget speech on February 21st, Arun Jaitley, India’s finance minister, called for a centralised Public Sector Asset Rehabilitation Agency (PARA) that could take charge of the largest, most complex cases and make politically tough decisions to reduce debt.

For some years, it seemed possible to resolve TBS as a minor problem, which would largely be resolved as economic recovery took hold. But the problem has only worsened. Earnings of the stressed companies have deteriorated, forcing them to borrow ever to sustain their operations. Since 2007-08, the debts of the top 10 stressed corporate groups have multiplied fivefold, from Rs 3.2 trillion to more than Rs 15 trillion. Even with such large infusions of funds, corporates have still had some problems servicing their existing debts—by September 2016, less than 12 per cent of the gross advances of public sector banks were non-performing. According to some private sector estimates, these numbers are considerably higher.

This situation is beginning to take a toll on the economy. With balance sheets under strain, the private corporate sector has been forced to curtail its investments, which has further reduced credit in real terms, which, in turn, has further reduced these investments, and so on. This vicious cycle needs to be reversed. And the only way to do so is by fixing the underlying balance-sheet problems.

The question is, how to do this? So far, the strategy has been to restructure the TBS through a de-escalation approach, under which banks have been put in charge of restructuring these large cases. A number of such schemes have been put in place by the Reserve Bank of India (RBI). Most of the time, this is indeed a de-escalation strategy. But in the current circumstances, effectiveness has proved elusive as banks have simply been overwhelmed by the sheer size of the problem. Eight steps lead to the conclusion that the time may have come for a more systemic, centralised approach, the PARA. A detailed case is set out in the new Economic Survey 2016-17, Chapter 4, “Tis is not without its own challenges. Indeed, there are other ways in which TBS was finding the funds needed by the public sector banks. But securing funding is actually a minor, and somewhat is solved by relaxing the rules or by a centralised approach. This is a major problem.

If an economic problem, not a monetary play. Without doubt, the trend of crowning capital per centages of the TBS problem. And it is true that these have been cases where debt relief programmes have been successful. And without doubt, the trend of crowning capital per centages of the TBS problem. And it is true that these have been cases where debt relief programmes have been successful. But it is also true that a vast bulk of the problem has been caused by the relaxed norms in the economic environment: Time-limited, exchange rates and growth rate assumptions that have gone badly wrong. The prospective nature of many capitalisation risks leading to punishing rather than incentive-compatible solutions.

For example, the problem of non-performing loans in large companies: Concentration creates an opportunity for banks to bring down their costs. But the problem is also the number of bad loans. It performs an even bigger challenge because large cases are invariably difficult, if not impossible, to manage. Many of these companies are susceptible to current levels of debt, requiring debt write-offs.

Rehab for the balance sheet

How would PARA actually work? There are many possible variations, but the broad outlines are clear. It would purchase specified loans (for example, those belonging to large, over-indebted infrastructure firms) from banks and then work them out, depending on professional assessments of the value-maximising strategy. Once the loans are off the books of the public sector banks, the government would recapitalise them, thereby allowing them to shift their resources—financial and human—back toward the critical task of making new loans. Similarly, once the financial viability of the over-indebted enterprises is restored, they will be able to focus on their operations, rather than their finances. And they will finally be able to consider new investments.

The writers worked on this year’s Economic Survey.