Ministry of Finance

Economic Survey 2016-17 suggests setting up of a centralised Public Sector Asset Rehabilition Agency
The Agency will look after the largest, most difficult Cases, and make Politically Tough Decisions to reduce Debt

Posted On: 31 JAN 2017 1:02PM by PIB Delhi

The Union Finance Minister Shri Arun Jaitley presented the Economic Survey 2016-17 in the Parliament today. The Survey shows that our country has been trying to solve its '*Twin Balance Sheet*'(TBS) problem – overleveraged companies and bad-loan-encumbered banks, a legacy of the boom years around the Global Financial Crisis. So far, there has been limited success. The problem has consequently continued to fester: Non-Performing Assets (NPAs) of the banking system (and especially public sector banks) keep increasing, while credit and investment keep falling. Now it is time to consider a different approach – a centralised Public Sector Asset Rehabilitation Agency (PARA) that could take charge of the largest, most difficult cases, and make politically tough decisions to reduce debt.

As per the Survey, gross NPAs has climbed to almost 12 per cent of gross advances for public sector banks at end-September 2016. At this level, India's NPA ratio is higher than any other major emerging market, with the exception of Russia. The consequent squeeze of banks has led them to slow credit growth to crucial sectors-especially to industry and medium and small scale enterprises (MSMEs)-to levels unseen over the past two decades. As this has occurred, growth in private and overall investment has turned negative . A decisive resolution is urgently needed before the TBS problem becomes a serious drag on growth.

Figure 1. Gross NPA Ratio (Per cent of Gross Advances)

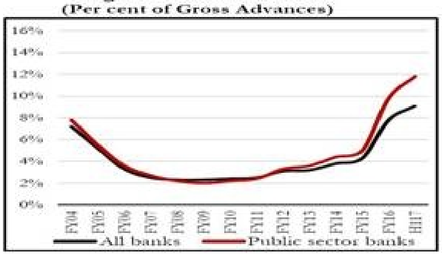
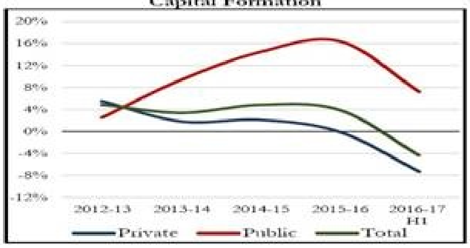


Figure 2. Growth in Real Fixed Capital Formation



The Survey reaches to the conclusion that a PARA may be necessary because

- Public discussion of the bad loan problem has focused on bank capital. But far more problematic is finding a way to resolve the bad debts in the first place.
- Some debt repayment problems have been caused by diversion of funds. But the vast majority has been caused by unexpected changes in the economic environment after the Global Financial Crisis, which caused timetables, exchange rates, and growth rate assumptions to go seriously wrong.
- This concentration creates a challenge since large cases are difficult to resolve, but also an opportunity since TBS could be overcome by solving a relatively small number of cases.
- Restoring them to financial health will require large write-downs.
- Among other issues, they face severe coordination problems, since large debtors have many creditors, with different interests. And they find it hard –financially and politically—to grant them sizeable debt reductions, or to take them over and sell them.
- It increases the costs to the government since bad debts of the state banks keep rising, and increases the costs to the economy, by hindering credit, investment, and therefore growth.
- Since, private run Asset Reconstruction Companies (ARCs) have not been successful either in resolving bad debts, though international experience (especially that of East Asian economies) shows that a *professionally run* central agency with the government backing could overcome the coordination and political issues that have impeded progress over the past eight years.

*****

DSM/UM/ST/RS