

### **Surgery needed, not pills**

While discussing the problem of non-performing assets in public sector banks in the last week's article, I had referred to the creation of a "*Public Sector Asset Rehabilitation Agency*" (PARA) proposed in the pre-budget Economic Survey. As of now, it looks like PARA may not happen in 2017-18, given the huge funding requirements of the organization, a significant proportion of which will need to come from the government, and the re-capitalisation needs of public sector banks. The total may well come to a few lac crores of rupees: the budgetary provision is barely Rs. 10,000 crores. Postponing the decision could well be counterproductive as the longer the delay in solving the problem, the greater will be the funding needs.

In the meantime, the Finance Minister has talked about creation of Oversight Committees under the auspices of the central bank to expedite the resolution of individual cases. Reports suggest that the chief of the Bank Board Bureau has supported the idea, and suggested expanding the role of the Committees and some technical refinements. The question is whether taking such pills will cure the ailing banking system when surgery of the type suggested in the Economic Survey, namely creation of PARA, is needed.

One way of solving the funding problem, which the Survey also hints at, is to deliberately depreciate the rupee so as to bring the real effective exchange rate index (REER) nearer 100. Even otherwise, rupee depreciation is needed if the output loss represented by the external sector is to be reduced, if not eliminated; this would also lead to creation of domestic employment in the organized sector which should be a priority for macro-economic policy. As I have argued previously in this column, the current account deficit, as reported, significantly under-estimates the output loss, because it is calculated after taking credit for secondary income, principally in the form of remittances. And, despite the huge subsidy we get from remittances from abroad, we have built up net external liabilities of the order of \$ 350 bn plus. Clearly, there is a

strong case to reduce, if not eliminate, the output loss, and use remittances to reduce the net external liabilities to more tolerable levels.

The fall of the rupee will yield a huge translation gain for the central bank – each fall of Re. 1 per dollar will lead to translation gain of Rs. 35/40,000 crores on the reserves. And, a fall to an index level of 100, could lead to a translation gain of perhaps Rs. 4,00,000 crores, meeting the funding needs of PARA and re-capitalisation. (Yes, this would mean some increase in inflation but that is far better than to allow the problem of bad debts to pester the economy for the indefinite future.) Over the last week the exact reverse has occurred with sharp INR appreciation, a point I will discuss next week.

### **Demonetization**

The results of the recent elections suggest that the demonetization exercise in the 3<sup>rd</sup> quarter of the current fiscal year has not really adversely affected the political fortunes of the BJP. Even the economy seems to have shrugged off the dislocation, with GDP growth in the last quarter estimated at 7%. Initially, there was a sharp increase in cashless, electronic receipts and payments, but consumers seem to have gone back to age-old habits.

The other side is that, at least so far, there is no hard evidence that the exercise has led to any significant discovery of unaccounted or counterfeit money. While the demonetization decision was doubtless a very bold one for the Prime Minister to take – there being no precedent, the political/economic repercussions could surely not have been forecasted with any degree of accuracy -- in retrospect, was the whole exercise a case of “Much ado about nothing”? Or, are we, as a people, more tolerant of illegal activities? In a recent book, “When Crime Pays: Money and Muscle in Indian Politics”, Milan Vaishnav reports that candidates facing criminal charges are three times more likely to win a seat in Parliament, than one who is not! In another recent book, “The Black Economy and The Black Money” Arun Kumar reports that the “shadow economy” in India, at an estimated 20.7% of GDP, was not very different from that in many other countries: Belgium 21.3, Finland 17, Greece 26.5, Italy 26.8, Norway 18, Portugal 23,

Spain 22.2, Sweden 17.9, and USA 16.1 (2007 data). Like Mrs Indira Gandhi used to say about corruption, unaccounted money seems to be a global phenomenon.

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