IL&FS Crisis of Lop - sided Development

The government of India took over the control of an Non-Banking Financial Company (NBFC), Infrastructure Leasing and Financial services (ILFS) saying that its collapse could potentially inflict "catastrophic" damage on India's "financial stability". It may be perplexing for the common man to understand how the collapse of a single company can endanger country's financial stability. Has the world's third largest economy, as claimed by the Finance Minister several times, became so brittle?

The ILFS was established to lend to the ongoing infrastructure projects. The major share holders are: LIC, SBI, UTI, HDFC and Central Bank of India. All are government owned financial entities. So, ILFS is a government owned company functioning under the finance ministry. The government is appointing its managing director and other board members. The announcement of takeover of ILFS is only a ruse, but for all practical purposes it is being managed by the government.

The ILFS as a NBFC is not allowed to raise deposits from the public. So, it raises funds from the debt market and lends at a higher interest rate to infrastructure projects such as highways, ports, airports, power projects etc. When they fail to pay back the loan, ILFS will not have money to repay the debt it incurred from the market.

The Reserve Bank of India (RBI) is the regulatory body for the functioning of NBFCs in India. It has well defined rules regarding the deposit-liquidity-equity ratios, which are mandatory for the NBFCs. Both the RBI and Finance minister ought to have known what is going on inside the ILFS. The credit rating agencies gave a triple-A rating to ILFC.

In September 2018, ILFS defaulted on a series of payments including Rs. 450 crore short term loans from the public sector SIDBI (Small Industries Development Bank of India). It is part of the ILFS repayment of massive Rs.3700 crore over the next six months. But in September, it had only Rs.200 crore in cash reserves. The total debt incurred by ILFS was Rs.91100 crore, of which about 60 per cent is owed to public sector banks.

When rising the market loans ILFC floated debt-equity norms far beyond 3:1 which could not happen without the knowledge of RBI and Finance minister. They wantonly ignored the signals. On the other hand, National Highway Authority of India and others defaulted on the repayment to ILFS to the tune of Rs.16000 crore. The PSBs are already mired in Non-Performing assets to the tune of Rs.9 lakh crore, the major part of which is owed by the construction companies involved in infra-structure projects. And inevitably ILFS collapsed.

How this fiasco happened? It's a long story that began back in 1990s with the advent of so-called new economic policies. The World Bank 'advised' the Indian government to build infrastructure in a big way in order to attract foreign investment for industrial development. The Indian govern-ment faithfully followed this advise without bothering to know how much of foreign investment would come and in to which industry to utilize this going to be constructed infrastructure. It is common knowledge that the infrastructure facilities are needed and constructed when there is definite setting of up industry and not the vice versa. Instead the government spent most of its finances and even borrowings on building infra-structure projects without knowing who is going to utilize them. This is horse-behind-the-cart policy.

Most of the toll collecting highways, including PPP model, failed to generate income to finance their loan burden. That is why the NHAI defaulted in its repayment including ILFS. Some of the PPP model highway projects are up for sale and could not find willing buyers. 14 highway projects under PPP model have struck midway due paucity of funds. Most of the newly constructed power projects, including those of National Thermal Power Corporation, are slipping to stressed assets, meaning defaulting on repayments of debts, because the Distribution companies are not willing to buy power from them as it is available at around half of the rate in open market. There are other causes also. The costs of the infrastructure projected were inflated to cushion the diversion of funds to the private participant and their political god fathers. As a result the assets created have actual value far less than spent amount. Naturally, they could not generate income far beyond their real capacity.

At the macro level of economy, barring a few initial years, most of the foreign investment came in to capture the existing industries rather than to build new ones. At the same time small and medium industries are regularly closing their shutters because the government is pursuing the policies that only benefits big corporate, particularly foreign. As a result, the manufacturing sector could not recover despite the tall claims by the leaders of government and their supporters.

The repeated tweaking of the GDP data cannot hide this fact. The overall GDP growth rate is around 7 per cent during the last ten years, while that of manufacturing sector hovered around 4 per cent and that of agriculture stayed below 2 per cent. At this, to say sarcastically, 'Hindu rate of growth', the economy could not provide employment and generate demand. Yet the stock markets are roaring with sensex reaching new record points. This means that the big bourgeoisie is making profits at the expense of small business and industries.

The ILFS fiasco is rooted in this lop sided policy. The creation of massive infrastructure without any idea who is going to utilize it tantamount to, as one economist observed, providing a big house to live to a person struggling to fill his stomach at least once a day.

The government immediate action to takeover ILFS is only meant to assure the financial markets (read foreign investor) that it will stand behind the company to prevent complete collapse of ILFS and to bail out its creditors with public funds.

Following the takeover of ILFS, the government went to National Company Law Tribunal asking for moratorium on creditors. Several major infrastructure projects came to halt throwing thousands of people out of work. The ILFS episode would affect the middle classes in coming months. Their hard earned saving were invested by LIC, UTI and others in ILFS. The returns on these savings will take a big hit. The small business and industries find it hard to raise even the working capital from the market. In the long run, the burden of ILFS fiasco would be transferred on to the backs of the people.

The ILFS fiasco may appear as a sudden unraveling; but it is boiling under the surface for a long time. It is part of the ever growing crisis that is engulfing every sector of Indian economy all these years. The crisis is not going to be abated, but strikes the lives of the people with ferocity in the coming months.

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