Source : www.indianexpress.com Date : 2018-10-02

BROKEN SYSTEM

Relevant for: Indian Economy | Topic: Investment Models: PPP, SEZ, EPZ and others

The Centre and the Reserve Bank of India have, for now, seemingly staved off the crisis resulting from the series of defaults by the Infrastructure Leasing and Financial Services (IL&FS) and its subsidiaries. The infrastructure developer and financing institution has unveiled a restructuring plan that involves a short-term bridge loan and a Rs 4,500-crore capital infusion through subscription to a rights issue by its primary shareholders, besides raising money via sale of existing assets. The whole objective has been to demonstrate that both IL&FS and its shareholders, especially the state-owned Life Insurance Corporation and State Bank of India, are fully behind the institution to ensure that its liabilities aggregating some Rs 91,000 crore are fully discharged. IL&FS has already moved the National Company Law Tribunal to reach an agreement with creditors for settling outstanding dues. The proposed plan, together with the RBI announcing liquidity infusion measures through open market operations, should help assuage fears of any contagion from defaults by a major financial institution. That would have been a disaster in the current scenario, where emerging markets, including India, are bearing the brunt of capital outflows due to the US Federal Reserve raising interest rates and soaring global crude prices causing a widening of current account deficits.

But even as IL&FS goes about repairing its broken balance sheet, the government and RBI need to seriously address the glaring governance failures and regulatory oversight responsible for the crisis. The problem with institutions like IL&FS is that they operate in a regulatory twilight zone of not being a bank and yet financing long-term infrastructure projects through mostly short-term borrowings. Worse, IL&FS used its private institution status to float innumerable subsidiaries and special purpose vehicle, even while choosing not be publicly listed. Where it was convenient, it also positioned itself as a quasi government entity for attracting investor funds. This was a model that allowed for little transparency and, at the same time, gave plenty of leeway for the senior management to reward itself top dog pay packets, including stock options, sans any accountability. That party has thankfully ended, but the revellers need to be brought to book.

More importantly, the IL&FS episode is a pointer to future challenges in infrastructure financing. India no longer has the old development finance institutions that were charged with funding capital-intensive long-gestation projects. Their absence led to banks filling the void during the 2000s with disastrous consequences. With the likes of IL&FS and IDFC (Infrastructure Development and Finance Company) also failing, a serious thought has to be given to the right institutional model for financing infrastructure — without which India can’t grow at 8 per cent on a sustained basis.

END