



## For a full bench

Progress in judicial appointment is welcome, but it is time for systemic change

The government and the Supreme Court collegium seem to disagree on recommendations for judicial appointments quite frequently these days. It has become routine to hear that some recommendations for High Court appointments, as well as elevation to the Supreme Court, have met with disapproval from the government. In such instances, it requires reiteration by the collegium for the names to be cleared. This need not always be a cause for concern if it is a sign of some serious consultation on the suitability of those recommended. However, it acquires the character of a controversy if the government's objections suggest an oblique motive to thwart or delay the appointment of particular nominees. The latest development concerns Jharkhand High Court Chief Justice Aniruddha Bose and Gauhati High Court Chief Justice A.S. Bopanna, who were on April 12 recommended for elevation to the Supreme Court. The government had sought a reconsideration of the two names. The collegium has now repeated its recommendations, emphasising that there is nothing adverse against the two judges in terms of their "conduct, competence and integrity" and that there is no reason to agree with the government. Under the present procedure, the government is now bound to accept the recommendation. The Supreme Court is keen to fill up the current vacancies. It has also recommended two more judges, Justice B.R. Gavai of the Bombay High Court and Chief Justice Surya Kant of the Himachal Pradesh High Court, for appointment to the apex court. If all these four recommendations go through, the court will have its full complement of 31 judges.

While this will be welcome, some issues persist. In systemic terms, the advisability of retaining the collegium system of appointments is a major concern; and in terms of process, the huge number of vacancies in the various High Courts and lower courts is another. The process of filling up vacancies depends on the relative speed with which the collegium initiates proposals for appointments and makes its recommendations after internal deliberations, and the time the government takes to process the names. As on May 1, the total number of vacancies in all the High Courts is 396. It is true that the filling up of vacancies is a continuous and collaborative process involving the executive and the judiciary, and there cannot be a time frame for it. However, it is time to think of a permanent, independent body to institutionalise the process. The known inadequacies of the collegium system and the mystery over whether a new memorandum of procedure is in the offing are reasons why the proposal for a constitutionally empowered council to make judicial appointments ought to be revived – of course, with adequate safeguards to preserve the judiciary's independence. The time may have come for a systemic and processual overhaul.

## A fraught moment

The U.S. and China need to take sustained steps to de-escalate tensions over tariffs

The U.S.-China trade war has flared up again after a deceptive lull over the last few months, when both sides were trying to negotiate a deal. Out of nowhere, President Donald Trump tweeted that he would raise the 10% tariff imposed on \$200-billion worth of Chinese goods to 25%, starting Friday. That the Trump administration pressed ahead with the increase even as China's Vice Premier Liu He was still in Washington for a second day of talks with U.S. trade officials only underscores the businessman-turned-President's 'take no prisoners' approach to negotiations. China promptly promised retaliatory action, but was yet to spell out the measures. With Mr. Trump tweeting that "the process has begun to place additional tariffs at 25% on the remaining" Chinese goods worth \$325 billion, the U.S. administration unambiguously signalled it was not going to be the first to blink. The latest revival in tensions between the world's two largest economies elevates the risk of a global trade war to its highest level since the first signs emerged in 2018. The increase in tariffs imposed on goods crossing international borders essentially represents a new tax on a global economy already facing a slowdown. Last month, the International Monetary Fund trimmed its projection for global growth in 2019 to 3.3%, from a 3.5% forecast made in January, citing slowing momentum in "70% of the world economy". IMF Chief Economist Gita Gopinath had at the time projected a pick-up in global growth momentum in the second half, predicated substantially on the "improved" outlook for U.S.-China trade tensions.

IMF chief Christine Lagarde and Ms. Gopinath, however, presciently warned that the world economy was poised at "a delicate moment". Were tensions in trade policy to flare up again, it could result in large disruptions to global supply chains and pose downside risks to global growth, the IMF warned. Barely a month later, the world economy faces the very real risk of an escalation in this trade war where other countries, including India, can largely only wait and watch as the U.S. and China raise the pitch. While the U.S. may have genuine concerns about Chinese protectionism, the overall economic logic behind Mr. Trump's trade policy still remains weak. The cost of these tariffs will, after all, eventually be borne by American consumers and could result in U.S. job losses too as the import of Chinese parts become uneconomical for smaller businesses. Indian policymakers would do well to closely monitor how the latest escalation in trade tensions pans out for global demand and international energy prices, given that the RBI has flagged oil price volatility as a factor that would have a bearing on India's inflation outlook.

# Resolving India's banking crisis

Acceleration in economic growth is not possible without addressing the problem of non-performing assets



C. RANGARAJAN & T.T. RAM MOHAN

The government that assumes office after the general election will have to crack a serious and unresolved problem: India's banking sector. To do so, it needs clarity on how the problem arose in the first place. Only then can it discard simplistic and ideologically-driven solutions in favour of those that can be effective.

Non-performing assets (NPAs) at commercial banks amounted to ₹10.3 trillion, or 11.2% of advances, in March 2018. Public sector banks (PSBs) accounted for ₹8.9 trillion, or 86%, of the total NPAs. The ratio of gross NPA to advances in PSBs was 14.6%. These are levels typically associated with a banking crisis. In 2007-08, NPAs totalled ₹566 billion (a little over half a trillion), or 2.26% of gross advances. The increase in NPAs since then has been staggering. How did this come about?

### Origin of the crisis

The answer lies partly in the credit boom of the years 2004-05 to 2008-09. In that period, commercial credit (or what is called 'non-food credit') doubled. It was a period in which the world economy as well as the Indian economy were booming. Indian firms borrowed furiously in order to avail of the growth opportunities they saw coming. Most of the investment went into infrastructure and related areas – telecom, power, roads, aviation, steel. Businessmen were overcome with exuberance, partly rational and partly irrational. They believed, as many others did, that India had entered an era of 9% growth.

Thereafter, as the Economic Survey of 2016-17 notes, many things began to go wrong. Thanks to problems in acquiring land and getting environmental clearances, several projects got stalled. Their costs soared. At the same time, with the onset of the global financial crisis in 2007-08 and the slowdown in growth after 2011-12, revenues fell well short of forecasts. Financing costs rose as policy rates were tightened in India in response to the crisis. The depreciation of the rupee meant higher outflows for companies that had borrowed in foreign currency. This combination of adverse factors made it difficult for companies to service their loans to Indian banks.

### Tightening norms

The year 2014-15 marked a watershed. The Reserve Bank of India (RBI), acting in the belief that NPAs were being under-stated, introduced tougher norms for NPA recognition under an Asset Quality Review. NPAs in 2015-16 almost doubled over the previous year as a result. It is not as if bad decisions had suddenly happened. It's just that the cumulative bad decisions of the past were now coming to be more accurately captured.

Higher NPAs mean higher provisions on the part of banks. Provisions rose to a level where banks, especially PSBs, started making losses. Their capital got eroded as a result. Capital from the government was slow in coming and it was barely adequate to meet regulatory norms for minimum capital. Without adequate capital, bank credit cannot grow. Even as the numerator in the ratio of gross NPAs/advances rose sharply, growth in the denominator fell. Both these movements caused the ratio to shoot up to a crisis level. Once NPAs happen, it is important to effect to resolve them quickly. Otherwise, the interest on dues causes NPAs to rise relentlessly.



SPECIAL ARRANGEMENT

This, in brief, is the story of the NPA problem. Since the problem is more concentrated in PSBs, some have argued that public ownership must be the problem. Public ownership of banks, according to them, is beset with corruption and incompetence (reflected in poor appraisal of credit risk). The solution, therefore, is to privatise the PSBs, at least the weaker ones.

There are problems with this formulation. There are wide variations within each ownership category. In 2018, the State Bank of India's (SBI's) gross NPA/gross advances ratio was 10.9%. This was not much higher than that of the second largest private bank, ICICI Bank, 9.9%. The ratio at a foreign bank, Standard Chartered Bank, 11.7%, was higher than that of SBI. Moreover, private and foreign banks were part of consortia that are now exposed to some of the largest NPAs.

The explanation lies elsewhere. PSBs had a higher exposure to the five most affected sectors – mining, iron and steel, textiles, infrastructure and aviation. These sectors accounted for 29% of advances and 53% of stressed advances at PSBs in December 2014. (The RBI's Financial Stability Report does not provide similar data for the period thereafter.) For private sector banks, the comparable figures were 13.9% and 34.1%. Our rough calculations show that PSBs accounted for 86% of advances in these five sectors. By an interesting coincidence, this number is exactly the same as the PSBs' share

in total NPAs.

As mentioned earlier, infrastructure projects were impacted by the global financial crisis and environmental and land acquisition issues. In addition, mining and telecom were impacted by adverse court judgments. Steel was impacted by dumping from China. Thus, the sectors to which PSBs were heavily exposed were impacted by factors beyond the control of bank management.

### Plans to prevent such crises

Wholesale privatisation of PSBs is thus not the answer to a complex problem. We need a broad set of actions, some immediate and others over the medium-term and aimed at preventing the recurrence of such crises.

One immediate action that is required is resolving the NPAs. Banks have to accept losses on loans (or 'haircuts'). They should be able to do so without any fear of harassment by the investigative agencies. The Indian Banks' Association has set up a six-member panel to oversee resolution plans of lead lenders. To expedite resolution, more such panels may be required. An alternative is to set up a Loan Resolution Authority, if necessary through an Act of Parliament. Second, the government must infuse at one go whatever additional capital is needed to recapitalise banks – providing such capital in multiple instalments is not helpful.

Over the medium term, the RBI needs to develop better mechanisms for monitoring macro-prudential indicators. It especially needs to look out for credit bubbles. True, it's not easy to tell a bubble when one is building up. Perhaps, a simple indicator would be a rate of credit growth that is way out of line with the trend rate of growth of credit or with the broad growth rate of the economy.

Actions need to be taken to strengthen the functioning of

banks in general and, more particularly, PSBs. Governance at PSBs boards, can certainly improve. One important lesson from the past decade's experience with NPAs is that management of concentration risk – that is, excessive exposure to any business group, sector, geography, etc. – is too important to be left entirely to bank boards. The RBI has drawn this lesson to some extent. Effective April 1, 2019, the limit for exposure to any business group has been reduced from 40% of total capital to 25% of tier I capital (which consists of equity and quasi-equity instruments). The limit for a single borrower will be 20% of tier I capital (instead of 20% of total capital).

### Risk management

Other aspects of concentration risk remain to be addressed. Overall risk management at PSBs needs to be taken to a higher level. This certainly requires strengthening of PSB boards. We need to induct more high-quality professionals on PSB boards and compensate them better.

Succession planning at PSBs also needs to improve. Despite the constitution of the Banks Board Bureau to advise on selection of top management, the appointment of Managing Directors and Executive Directors continues to be plagued by long delays. This must end.

The task of accelerating economic growth is urgent. This is not possible without finding a solution to the problems that confront the banking system. There is ample scope for improving performance within the framework of public ownership. It can be done. What is needed is a steely focus on the part of the government.

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## New clouds over the Persian Gulf

Iran's decision to withdraw partially from the nuclear deal is risky, and could play into U.S. plans



RAMINI JAHANBEGLOO

Iranian President Hassan Rouhani announced on Wednesday that Iran will withdraw partially from the landmark nuclear deal of 2015. Iran's decision to reduce its commitments to the Joint Comprehensive Plan of Action (JCPOA), known as the P5+1 agreement, comes as a reaction to the U.S.'s attempts in recent weeks to reduce Iran's oil exports to zero. As a response to U.S. sanctions, Iran is demanding that the remaining signatories of the deal – the U.K., China, France, Germany and Russia – ease the restrictions on its banking and oil sectors in the next 60 days. In case the five endorers of the deal decide not to act in favour of Iran, the authorities of Tehran will remove the caps on uranium enrichment levels and resume work on the Arak nuclear facility.

### Loss of patience

Iran's plans are very clear, and they put an end to long and laborious multilateral negotiations which put strict limits on Iran's nuclear activities in return for lifting

most international sanctions. Undoubtedly, Iran's decision comes as an expression of loss of patience with a deal that is providing very few of the promised economic benefits. But by resuming its uranium enrichment operations, Iran could be taking a huge risk, putting at danger its diplomatic relations with Europe and playing the game of the Trump administration that has been taking a hard line against Tehran.

Consequently, Iran might be economically isolated, but the message coming out from Russia is that Iran is not alone. The Kremlin has joined Tehran to accuse the U.S. of retreating from the nuclear deal, while approving Iran's rolling back of some of the terms of the deal due to pressure from the U.S. Of course, the Russian gesture is not without some long-term interests for the Kremlin. U.S. sanctions against Iran will certainly result in the development of cooperation between Moscow and Tehran, but also with countries like Turkey which are important to American foreign policy.

This said, the goal of the Trump administration in applying the new series of sanctions is likely to hit the earnings of Iran's major metals companies, such as Mobarakeh Steel and the National Iranian Copper Industries Company. This will have an immediate im-



HASAN ROUHANI - AP

pact on the Iranian government's revenues, but it will also deteriorate the balance sheets of Iran's heavily indebted metals and mining companies. No doubt, this situation will be followed by mass unemployment, especially among blue-collar workers employed by state-owned enterprises who form the backbone of Iran's economy.

### Stoking unrest

It is no secret that last year the 2.5-million-strong government workforce did not get a raise while prices accelerated. To this end, the Trump administration's "maximum pressure" policy on Iran aims directly to stoke social unrest in Iranian cities by creating labour strikes (in the Polish style of Solidarity back in the 1980s) within the metals industry. For Donald Trump and his aides, the outcome of their confrontation with Iran is clearly to deprive the Iranian regime of the funds it can use to impose its hegemony around West

Asia, but also to put pressure on the everyday life of Iranian citizens. From the Trump administration's perspective, the economic malaise in Iran should stoke protests sooner or later. But does this mean the beginning of the end of the regime of the Ayatollahs?

Things are more complex than they might appear. If we take a close look at the geostrategic situation of West Asia, Iran's threat to violate the JCPOA is a very worrisome decision. Let us not forget that from Iran's perspective, Mr. Trump's America is considered a rogue state. As for the Trump administration, it considers the Islamic regime in Tehran as its Enemy Number One in West Asia. The recent announcement by John Bolton, Mr. Trump's National Security Adviser, that the U.S. was dispatching an aircraft-carrier strike group and bombers to West Asia to protect American allies and their interests is an unmistakable attempt to intimidate the Iranian regime. Over the past few weeks, the White House has intensified its campaign of pressure and threats against the authorities in Tehran and the Iranian Revolutionary Guard Corps (IRGC). In Washington's eyes, Iran is a rogue state because of its support of militant groups, its violations of human rights, and its pursuit of nuclear-related technologies.

But despite the sanctions, Iran continues to fund its proxies in the region, prepare missile tests and support the Syrian regime of Bashar al-Assad. Thus, at the point where things stand, it is very hard to imagine a turn towards negotiations, although some European countries might continue encouraging a return to diplomatic management of the Iranian crisis. There is little likelihood of any flexibility towards the Iranian regime from the American side till the November 2020 U.S. presidential election. Iran will certainly look for ways to inflict a cost on the U.S. directly or through militia proxies in the region. In that case, the scene will be set for military confrontation between Iran and the U.S.

Last but not the least, if Iran's leadership is to successfully resist U.S. "maximum pressure", it must do more than choose the military path. Those who oppose any unilateral U.S. military action against Iran can only hope that the Ayatollahs and the IRGC will not react violently to U.S. forces in the region and to its allies. In case that happens, troubled times are ahead for Iran, West Asia and the global market.

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## LETTERS TO THE EDITOR

Letters emailed to letters@thehindu.co.in must carry the full postal address and the full name or the name with initials.

### Low public discourse

Prime Minister Narendra Modi has referred to former Prime Minister Rajiv Gandhi as "Bhrashtachari No.1" ("Abusing a martyred PM is ultimate cowardice: Congress", May 10). Earlier, Congress president Rahul Gandhi called Mr. Modi a "chor". Interestingly, the courts have found no evidence against either Rajiv Gandhi or Mr. Modi in the Bofors and Rafale cases, respectively. This only shows how low our public discourse is today – accusations and name-calling are rampant with no basis in facts. I have a couple of questions for Mr. Modi, though. Why talk about Rajiv Gandhi at the end of this election?

Why is this important for this election? Why did he keep quiet all this time? Why is his party talking about Pakistan, Balakot and Rajiv Gandhi instead of its five years in power?

MOHAN ARIMBOOR, Thiruvallur

Mr. Modi's strategy is to divert our attention from the crucial problems we face today. He seems to be maintaining a stoic silence on the fallout of demonetisation, unemployment, and the problems of GST, while harping on the anti-Sikh riots and Rajiv Gandhi.

N.C. SREEDHARAN, Kannur

The shameful remarks

made against the Aam Aadmi Party's Atishi show yet again how low we have descended as a society ("AAP candidate accuses Gambhir of slander", May 10). Why should anyone talk of Ms. Atishi's past relationships instead of her work? Why should the Prime Minister drag an assassinated Prime Minister into an unsavoury controversy? Rajiv Gandhi isn't alive to defend himself. How can politicians ask for votes in the name of the defence forces? This is a dangerous trend that will affect the apolitical character of the forces. Where are the statesmen of this country? Elections come and go but we can't afford to lose the

soul of the nation. R.D. SINGH, Ambala

### Ground realities

BJP president Amit Shah, in his assertion that the NDA will better its 2014 performance, seems to ignore the ground realities ("We will increase seats, improve our margins of victory and expand", May 10). Opposition alliances in U.P., Karnataka and Maharashtra are new in this election. Even if anti-incumbency is marginal, it could affect the NDA's vote share and seat share. The BJP's uneasy alliance with the Shiv Sena is not going to improve its tally in Maharashtra. Mr. Modi is not able to create the awe

that he could in the last general election. That is why he is busy talking about Rajiv Gandhi.

V. SUBRAMANIAN, Chennai

### Gogoi case

The most important requirement of any inquiry is that the person conducting the inquiry must be independent, i.e., he or she can have no relationship, including a professional one, with the parties to the inquiry ("By established law and procedure," May 10). That principle was grossly violated in the inquiry against the Chief Justice of India. It is natural for those working together to be constrained by professional

brotherhood. This point has been missed in the analysis.

VASANT NARAYAN DESHMUKH, Bengaluru

It is difficult to agree with the views expressed by the writer. There were several issues apart from sexual harassment that cannot be overlooked in this case, such as frequent transfers of the complainant, actions taken against her family and intimidation, as reported by her. Justice must not just be done, but must be seen as done. This unfortunately has not happened in this case.

V. NARAYNEN, Chennai

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