GOVERNMENT OF INDIA
FINANCE
LOK SABHA

UNSTARRED QUESTION NO:175
ANSWERED ON:16.11.2007
CREDIT AVAILABILITY TO SMALL SCALE INDUSTRIES
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Will the Minister of FINANCE be pleased to state:

(a) whether implementation of Basel II norms by the banking sector will reduce credit availability to Small Scale Industries (SSIs) besides adding to their cost fund;

(b) if so, the details thereof;

(c) whether the attention of the Government has been drawn to a recent paper of the Indian Council for Research on International Economic Relations (ICRIER) on `Capital Adequacy Regime in India - an overview`; and

(d) if so, the reaction of the Government thereto?

Answer

THE MINISTER OF THE STATE IN THE MINISTRY OF FINANCE (SHRI PAWAN KUMAR BANSAL)

(a) to (d) : Indian Council for Research on International Economic Relations (ICRIER) has published a paper titled `Capital Adequacy Regime in India - An Overview` in July 2007 wherein it has been, inter-alia, stated that under the proposed Basel II norms, banks will be discouraged to lend to unrated small scale industries (SSIs) because loans to unrated entities would attract 100% risk-weight. The paper claims that as SSI sector in India is so far out of reach of the credit rating industry, bank lending to this sector may go down. The paper further adds that the additional cost of credit rating will affect the economic viability of a large number of SSI units. Reserve Bank of India has issued `Guidelines for Implementation of the New Capital Adequacy Framework` on 27.04.2007 to adopt the Basel II norms, taking into account the elements of credit risk in various types of assets in the balance sheet as well as off-balance sheet business and also to strengthen the capital base of banks. The RBI guidelines are intended to strengthen the financial and banking system in the country besides inculcating a sense of financial discipline among the borrowers. The guidelines also prescribe risk-weights as low as 20% in case of `AAA` rated, 30% in case of `AA` rated and 50% on `A` rated corporate claims. Implementation of Basel II norms by the banking sector does not have any direct relationship with the availability of credit to any particular sector. Under Basel II norms, the capital allocation for an exposure is based on the risk weight assigned to that exposure. Moreover, risk weight is only one of many parameters which influence the banks` lending decisions. Further, as most banks have already been using some kind of ratings / grades to price the borrowers including SSI borrowers, the introduction of Basel II norms may not make any significant difference to the cost of funds for the SSI borrowers.