Transcript for Session on Financial Markets, IGC-ISI Conference
20 December 2010

Presentation 1
State Ownership and Systemic Risk, Viral Acharya

In the aftermath of the financial crisis of 2008, Indian public sector banks were lauded for their resilience and stability. They outperformed private sector banks during the crisis with respect to various measures, especially deposit growth. The authors argue against using these ex-post performance measures in presence of government guarantees to these public sector banks. They question the widespread belief during the time that public sector banks, due to state ownership, are inherently more stable, and thus perform better during crisis. They suggest that this difference in performance should be attributed to state guarantees and not state ownership.

Their criticism rests on their measure of risk called Marginal Expected Shortfall (MES). It is a measure of risk similar to Beta, but captures the contribution of a firm to systemic risk only in the event of a crisis. They compare ex-ante MES of all banks to their ex-post performance during the crisis period. While private sector banks expectedly display a negative relationship i.e. riskier banks (higher MES) have lower returns, the public sector banks display a positive relationship. The authors explain this surprising result by suggesting that the riskier public sector banks received the highest state support during the crisis and hence performed better.

These results have important policy implications. Deposit growth sustained on the basis of government guarantees has the potential of crowding out the private sector, which is ex-ante less risky (MES of 3.58% while PSBs have MES of 4.34%). This highlights some of the dangers of delaying privatization of the Indian financial sector.

Presentation 2
Infrastructure and FDI, Rajesh Chakrabarti et al.

Foreign Direct Investment (FDI) is the largest component of net capital inflows into emerging markets and government policies usually aim to attract as much of it as possible. Countries with better infrastructure enjoy a comparative advantage in attracting FDI. Therefore, studying the impact of public infrastructure on FDI inflows is of great relevance to scholars as well as policymakers. Chakrabarti et al. attempt to do the same.

The authors establish that in India, the impact of public infrastructure on FDI inflows is positive but non linear. FDI inflows remain insensitive untill the level of public infrastructure reaches a certain threshold level and thereafter they continually increase. That is why marginal improvements in bottom rung countries fail to attract multi national enterprises. However the nature of this relationship is hard to capture

across countries due to differences in several dimensions. Indian settings offer favorable conditions to study this relationship.

Chakrabarti et al. use a unique district level dataset created by CMIE known as *CapEx* which provides information about the location of the project, foreign collaborations, value of the projects etc. and *Indian Development Landscape* which is a new dataset created by Indicus Analytics providing information on socio-economic indicators. They exploit the cross sectional variation among districts within a state to establish that better infrastructure positively affects FDI inflows, albeit in a non-linear fashion. Since there is literature which argues that FDI inflows may be due to agglomeration externalities or demand side effects, Chakrabarti et al. control for such endogenous factors. The authors' results seem to explain the success of the SEZ approach and offer suggestions to policy makers for optimal use of resources in creating infrastructure to attract FDI inflows.

Presentation 3
Credit Rationing in Informal Markets, Sankar De

This is the first paper in India to provide evidence of the rationing of informal credit. The motivation came from asking: Can informal private arrangements substitute for formal public institutions? If yes, it has important implications for countries with weak formal institutions. However, the authors argue that this is not the case.

The authors construct a unique dataset comprising data collected from a survey of company owners/CEOs of SMEs and corporate finance activities data collected for the same firms from *CMIE Prowess*. Using a simple specification, the authors provide strong evidence of rationing of credit within informal relationships. They also find that firms with smallest asset bases bear the brunt of this rationing. Their evidence is consistent with a moral hazard model of credit rationing.