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# Why an ill-thought crusade against NPAs could push the economy further downward

**By KM Chandrasekhar ( former Cabinet Secretary)**
**Economic Times 1-10-2017**


NPAs can arise through bad banking practices.
They can also be the result of economic slowdown.

The state of the Indian economy has been the flavour of the week. There has been informed discussion, acrimony, pathos, sarcasm, the works — and, that too, coming from significant political dignitaries, past and present, economists of all hues and people who know everything and hold strong and unshakeable views.

The economy is a dynamic process, ever changing. Rigid views and opinions do not sit well in dynamic situations. It was reassuring to hear from the Finance Minister that government would be proactive, that it would analyse the situation and take remedial action where necessary.

This implies a readiness to change track and move quickly. Whether in the economic field or any other sphere of human endeavour, there will always be triumphs and failures, mistakes and corrections.

**Need for Change**

That the economic situation deserves attention is a fact beyond dispute. The growth rate has declined to 5.7% in the first quarter of 2017-18. There is prevailing concern over rates of growth in the job market. Exports have been falling as the sluggish global economy struggles to find its feet again.

Credit offtake fell to 3.3% in February this year. Above all, rates of investment and rates of domestic saving have dropped sharply. The stock markets are beginning to show signs of fatigue. There is singular lack of interest in IPOs. Clearly, this is no time for business as usual and a realisation that change is necessary is the first step forward.

Hopefully, that first step is now behind us. The global situation shows signs of some improvement. The World Bank puts global growth this year at 2.7% against 2.3% in 2016. The IMF gives figures of 3.1% in 2016, 3.5% in 2017 and an expected 3.6% in 2018. The World Trade Organization forecasts an improvement in global trade from 1.3% in 2016 to a range of 1.8% to 3.6% in 2017 and 2.1% to 4% in 2018.

All these figures show a rising trend and it would depend on the wisdom and sagacity of policy makers to make full use of the emerging global opportunities.

The answers to the problem are many and, no doubt, the newly appointed economic advisory council is working on them. The most significant element in any package of solutions should be raising the level of investment, whether it is public or private. A gross fixed capital formation to GDP ratio of about 27%, down from a level of 34% in 2013-14 is obviously not good enough.

I read an article recently by Sashi Sivaramkrishna of Narsee Monjee Institute which brought out some interesting facts. He talked of a 2013 working paper of Bose and Bhanumurthy of National Institute of Public Finance and Policy (NIPFP), which estimated the capital expenditure multiplier as 2.45. That is, if government spends a rupee on capital expenditure, GDP will rise by Rs 2.45. Thus, assuming these rates, an expenditure of Rs 40,000 crore will lead to additional GDP growth of 0.75%.

Likewise, studies done by the International Labour Organisation in Gujarat and West Bengal on employment multipliers in road construction show that a 2% increase in GDP could potentially create 6 crore more jobs. Of course, some part of the multiplier effect would be absorbed by supply side constraints, which could result in inflation in areas where such constraints exist but, in an economy generally characterised by relatively high unutilised capacities, the inflationary effect would be minimal.

And, really, what option do we have when private investment rates are so low? Whenever we talk of increased public investment, we confront an impassable barrier erected by many who believe in the sanctity of keeping the fiscal deficit at an arbitrary level of 3% or so. The fact is that the fiscal deficit ratio consists of a numerator, the fiscal deficit in absolute terms and a denominator, the GDP. Higher investment would raise the numerator, but the higher investment would itself raise the denominator through the multiplier effect. Thus the fiscal deficit, in due course of time, would correct itself.

The 2008-09 stimulus, which led to quick economic recovery, was blamed for inflation which came some years later, but this was perhaps more of a political reaction, which deliberately turned a blind eye to a host of other factors inducing inflationary pressures.

**The GST Quotient**

To raise private investment, production and utilisation of capacity have to be pushed up by profit considerations. This would involve raising effective demand through the purchasing power route.

The GST effect has to be carefully monitored and the basic price-reducing effects of input credits would need to be passed on to the consumer. This is at present constrained in practice by lack of full knowledge of how GST works, delays in grant of input credits, shortfalls yet to be set right in the GST network. Perhaps it will even out in time and market forces will prevail, but it is difficult to hazard a guess on how long it will take.

Meanwhile, there is pervasive fear in the lowest rungs of the supply chain of excessive regulatory action and the return in full force of the dreaded tax inspector. This fear is exacerbated by the fear of linkage with the income tax network which would pose a new set of problems, particularly if retrospective assessment provisions are used.

Unless carefully managed, the negative effects of GST can outweigh the positives a couple of years down the line. The effect on prices of high overall taxes on non-GST products, especially petroleum products, has to be studied and readjustments made. Identification of job creating, quick yielding areas for targeted intervention would also yield dividends.

Interest rates at this point may not be a significant factor in creating a climate for investment. But too much obsession with NPAs and regulation may be counterproductive.

NPAs can arise through bad banking practices. They can also be the result of economic slowdown. Unless a distinction is made between the two, the crusade against NPAs could push the economy further down. Mature fiscal and financial management and stability should be the watchwords. The writer is a former cabinet secretary

# Centre may delay PSU banks' merger

30 Sept 2017 – Deccan Herald

Even after the Cabinet's approval, the government may delay the merger of public sector banks by a few more quarters owing to the economic slowdown.

"The merger plans could be postponed as the state-owned banks' balance sheet is woefully weak and it does not augur well for the government to put in public money in them beyond a limit when the economy is not doing well," sources close to the development told DH.

Merger plans would require a lot of capital as combining weak banks will not be a viable option. But the sharp rise in bad loans of banks has weighed on economic development and the government may attempt to clean up the PSU banks of around Rs 10 lakh crore of bad loans, they said.

The government had earlier planned to create 3-4 global-sized banks by merging small entities. Finance Minister Arun Jaitley had earlier said that the government was "actively considering" consolidation of banks, and was planning at least one more merger before March 2018, after SBI and five of its subsidiaries became one entity.

However, the finance minister at a media even in Mumbai recently was heard as saying that the consolidation of banks will have to move parallel to the objective of strengthening of banks. This was interpreted by analysts as a marked shift from the government's earlier stance of nudging the PSU banks to come forward with merger plans.

Thereafter, the finance minister also said that the government was open to policy changes to respond to challenges faced by state-owned banks. The government had earlier estimated that the PSU banks would need around Rs 2.5 lakh crore of capital, of which Rs 1.1 lakh crore would to come from the market, Rs 60,000 crore from profits, and the remaining Rs 70,000 crore as budgeted amount for the next four years.

The plan was subsequently criticised by the government's own policy makers, the Reserve Bank of India and global agencies. Fitch Ratings earlier this month had said PSU banks will need an over Rs 4 lakh crore of additional capital by March 2019.

Sources said the Bank Board Bureau, which is tasked to suggest the government on consolidation of banks, has also sought more capital to strengthen weak banks before their merger. In February, India's largest public sector lender SBI merged with five of its associate banks - State Bank of Bikaner and Jaipur, State Bank of Hyderabad, State Bank of Mysore, State Bank of Patiala and State Bank of Travancore. Thereafter, the talks were ripe to merge Vijaya and Dena banks.

# Modi’s Promise of a ‘New India’ Looks Shaky Amid Economic Chaos

BY M.K. VENU ON 25/09/2017

**With the ripples of demonetisation and a poorly-designed GST spreading economic distress, voters will assess the promise of Narendra Modi’s ‘New India’ in due course.**

*People associated with the BJP’s ideological parent, the Sangh Parivar, have also started expressing concern over India’s economic trajectory.*

Suddenly, the BJP is feeling besieged by news of economic distress all around. After a badly botched up demonetisation exercise, we are seeing an equally botched up implementation of the GST which has sent small businesses into a tailspin, exacerbating the decline in output and employment seen during the months after demonetisation.

Trading companies were de-stocking before the start of the GST regime on July 1, 2017, in the hope that they would buy up fresh stocks under the new tax system. But given the messy implementation, analysts say the re-stocking process is quite slow and firms would rather wait for the GST system to stabilise before going full swing again. And mind you, all this is happening just before the festive season. This is bound to impact GDP growth in the second half of 2017. As predicted by many, inflation too has marginally gone up post GST. The multi-decade high domestic petrol and diesel prices are not helping matters either. Ironically, record high oil taxes are the only source of stable revenues as they are out of GST. It is India’s oil tax and not GST which is coming to the Centre’s rescue.

To add to finance minister Arun Jaitley's woes, the sub optimal – perhaps an understatement – working of the GST network (GSTN) has created a major risk of revenue shortfall in 2017-18, putting the Centre's fiscal arithmetic at risk. The finance ministry got its first shock when the GST refund applications (those seeking refunds after paying tax) totalled Rs 65,000 crore for July when total collections were Rs 95,000 crore.

If all refunds were allowed, the Centre would be left with just Rs 30,000 crore when actual net collections are budgeted at over Rs 90,000 crore a month on average. Since more refund claims were expected in the first month because of refunds being allowed on older stocks, it is projected that the subsequent months would generate much higher GST revenues. But given serious glitches that have occurred in the software of the GSTN, the entire exercise is in jeopardy this fiscal.

Bihar deputy chief minister Sushil Modi, who heads the newly created committee of state ministers to fix the myriad problems with the GSTN, made a telling comment last week when he said, "We are building a ship while sailing in it". Clearly, this is an indictment of the Centre which launched the GST without being prepared for it.

Karnataka's agriculture minister, Krishna Byre Gowda, a member of the new committee, told ***The Wire*** that there are several problems with the software of the GSTN which will take at least six months to fix. He said, "At present there are basic issues like businessmen saying they have registered and uploaded returns but our system not showing it. The slowness of the system is causing hardship to users. The system is not yet able to facilitate uploading of invoices and returns at various stages such as GSTR 2 and GSTR 3. And worse, state governments are unable to retrieve data on companies to monitor GST payment."

Gowda says the committee members have spoken to the software providers in Infosys and "they are saying the procedural protocols were received at the eleventh hour before the kick off date in July. There wasn't enough time to do trial runs". So we now fully understand what Sushil Modi means when he says the ship is being built as it is already sailing!

Top Sangh ***parivar*** ideologues belatedly admit that the unstable ship is sailing in the already stormy waters caused by demonetisation. S.

Gurumurthy, an important economic ideologue of the Sangh parivar, has suggested that the coming together of demonetisation, GST, bank NPAs settlement process and the multi-pronged attack on black money have delivered a huge shock to commerce in general.

Gurumurthy's admission is very interesting because he was the biggest defender of demonetisation, GST and the taxman's arbitrary assault on individual entrepreneurs and small businesses in particular. The tax department is not going after the big businesses with whom it is known to enjoy a long-standing cosy relationship. To understand this, you just have to see the number of senior tax officials who quit and join the top 500 companies in India.

So Sangh parivar ideologues now openly concede that Modi and Jaitley may have thrown the baby out with the bath water. The current phase of GST implementation is the biggest example. Businesses who have paid the GST for July and asked for legitimate refunds are being hounded like criminals. Exporters were always exempted from excise duty earlier because they competed in the global market. Under the GST regime, since all businesses pay the indirect tax as a matter of procedure, exporters were asked to pay 18% GST only to be refunded the same amount forthwith before shipping their consignment abroad. But now exporters are complaining that their tax refunds are not coming in time. Exporters cannot wait as they work in seasons – like shipping for Christmas abroad. Their working capital gets blocked after they pay 18% GST, which is a big amount. They end up paying additionally for borrowing to meet short-term working capital from banks, affecting their narrow profit margins.

Imagine India has close to $300 billion annual exports and this contributes a good chunk to GDP. And the GST authorities appropriating 18% of the export value and not refunding the amount in time is a nightmare for them. This simple equation of quick refund to exporters was not anticipated by the finance ministry. Someone must surely pay for this.

Given the scale of the mismanagement of GST, I will not be surprised if GDP growth in the second half of 2017 goes down even further from the 5.7% recorded in April-June. Indeed, despite BJP President Amit Shah's bravado that people should " ignore official statistics" there is panic within the government over the dark clouds gathering around the economy. The scale of value destruction in India' s informal sector, especially agriculture and small industry has been documented comprehensively. Social media is giving a running commentary backed by data for some months now. An RBI survey of the universe of smaller companies ( turnover less than Rs. 25 crore) shows a 58% fall in their sales in Jan- March 2017. GST would have further added to their distress post July.

The Mumbai-based research arm of international financial services group , Credit Suisse, recently said the Indian economy is going through a dense fog with several big policy measures like demonetisation & GST creating major disruptions. More worryingly, Credit Suisse says these disruptions are accompanied by a sharp fall this year in overall government spending. Remember in the absence of private investment , public investment was probably the only engine generating some growth so far.

Eighteen months before the 2019 general elections, India's political economy is in a shambles as Modi continues to make impossible promises to be fulfilled by 2022. The underlying message behind these new promises is that his coming back to power in 2019 is pre-ordained. History informs us that politics invariably evolves in a non-linear fashion. Sands begin to shift from under the feet just after the hubris and popularity of a regime peaks. By the end of 2018, voters will make a realistic assessment as to whether the promise of a " New India" is for real or yet another bubble destined for the dustbin of Swachh Bharat.

| AIBEA THIS DAY – 1 OCTOBER | |
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| **1959** | **State Bank of India Subsidiary Banks Act. passed.** |
| **1964** | **Tripartite Meeting at Delhi : CLC, IBA and AIBEA: Discussions on Wage revision demand** |


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