Economy This Week (2nd Sep to 15th Sep 2019)

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1. Merger issue - free the banks - criticism (BS 2/9/19)

- Govt recently has announced merger of 10 public sector banks into 4. This is not the first time that the govt has gone for such mergers, earlier it announced merger of three PSBs – Dena Bank, Vijaya Bank and Bank of Baroda; and before this merged the five associate banks of SBI with the parent bank; and also merged Bharatiya Mahila Bank with SBI
- Operational efficiency from such merger of public sector entities has remained elusive
- The question on especially the independence of the banks is raised when the govt takes such strategic decisions on their behalf (it should be taken by the bank boards as it is their responsibility)
- If govt wants to bring in reforms in the banking sector, there are recommendations from various committees such as P J Nayak Committee
    - Make legal changes in order to reduce the ownership of the government in PSBs to below 50%
    - For this there is a need of setting of Bank Holding Company (this would act as a firewall between the govt and bank)
- Govt has put the recommendation on the back burner and set up BBB (Bank board Bureau) as an interim step, but even this has proven ineffective.

2. Bank mergers - need for PSBs (IE 5/9/19)

- In short term the mergers will not do anything to turnaround the economy, rather the challenges related to mergers will divert the attention from credit offtake and management of NPAs in the economy
- The focus of the employees will be on their job security, work culture issues etc when it should be scouting for new clients
- Whenever the bank mergers are done keeping in mind the efficiency and business considerations, they would yield some results but in case of mergers which are being arranged by the govt it is debatable whether there would be any benefit
- Benefits of large bank
    - Will provide economies of scale through
        - Centralised bank office processing
        - Elimination of branch overlap
        - Eliminating redundancies in administrative infrastructure
        - Better manpower planning
        - Optimum funds management
        - Savings in IT and other fixed costs
    - Will be able to lend to large projects on their own while staying in prudential norms
- Issues related large bank
    - They can become too big to fail and may increase the risk of spillover effect (In fact to counter this issue itself the banks such as SBI were identified as Systemically Important

Banks and were asked to maintain higher capital requirements)
    - The tacit knowledge that govt would come to the rescue may encourage irresponsible behaviour by the banks
- Do we need PSBs
    - The banks were nationalised 50 years ago, the context, the economic situation etc were different. The banks after nationalisation have led to penetration of banking services, implemented a variety of anti-poverty programmes etc. So with this in mind the question is do we still need the PSBs?
    - The reforms so far announced by the govt in the banking sector are not structural and these will not go a long way in providing the much-needed impetus for the economy, rather the govt should look into announcing measures such as reducing its majority stake in the PSBs which will go a long way in moving towards $5 tn economy.

3. Slash income tax rates to put money in people's hands (LM 4/9/19)

- In order to push up the consumption demand in the market, the govt may look into putting more money in the hands of the taxpayers. The favourite way of doing this is by providing the tax cuts. This would lead to higher demand and in turn would prompt the businesses to make investments in the market
- On the other hand, providing the tax cuts will have a negative impact on the finances of the centre. Already the collections have lagged the projections and if the govt provides tax cuts then it would be problem for fiscal consolidation
- Despite this keeping in mind the larger picture i.e. slowdown in the economy, trying to revive the demand through this route would be a good attempt
- There is an attempt to overhaul the whole system in areas such as restructuring the slabs, income assessment, scrutiny systems etc. in this regard govt has set up a panel for reforming the DTC, which has already submitted the report
- For now, the govt could make certain changes to the law in order to reduce the tax rates
    - Income tax rates could be lowered
    - Various other levies could be lowered (like withdrawal of the surcharge on the FPIs).

4. GST shortfall may be the next worry for the govt (LM 5/9/19)

- Unless the trend reverses, the govt may have ₹ 40000 Cr lesser GST revenue
- Along with lower manufacturing activity, the services sector growth also has lost steam for the month of August (this is important as the services sector accounts for more than half of the GDP)
- The revenue shortfall also may lead to govt compensating the states for the revenue loss (govt has promised states that the GST tax revenues would increase by 14% annually), though the govt imposes Cess to collect and pay for the compensation, if the compensation is higher than the cesses collected, the excess has to be paid from the financials of the government.

5. Fear of imported inflation rises (LM 9/9/19)

- When the price levels in the domestic market increases because of the imported commodities it is referred to as imported inflation
    - The price of imported commodities might increase because the market prices of these have increased

- It might also be because the domestic currency (i.e. rupee) has depreciated
- Rupee value has depreciated from 68-69 per dollar in the month of march to 72 per dollar this month
- Rupee has been the worst-performing Asian currency, and has depreciated by 2.72% this year alone
- The investors may feel that with RBI further reducing the interest rates, there could be higher inflation rates in the future
- Though the CPI basket is weighted to domestic goods and services, the impact of exchange rates on it would be muted. However, RBI estimates that a 20 bps impact on CPI inflation from 5% depreciation of rupee
- Another reason for limited impact in the present scenario could be that the demand in the market has already slowed down and if the manufacturers decide to transfer the costs to the consumers, the demand might further decline.