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Economy This Week (29th June to 5th July 2020)

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1. Making GST work (BS 1/7/20)

- GST was introduced in order to attain multiple objectives:
  - Creating a single market for goods and services
  - Simplifying the indirect tax system
  - Improving compliance
  - Raising resources for both centre and state governments
- The experience of the past three years has shown that a lot has been achieved with GST.
  - Most important being, how the GST council has worked. It is no surprise that the demand for using the same model for addressing other centre-state relations is being made.
  - It has made India a single market.
  - Trucks are not stuck at the state borders anymore and their turnaround times have improved. It has allowed companies to plan their logistics more freely.
- Issues:
  - Revenue collection has fallen short. This has resulted in fiscal management problems for both centre and states. Reasons for this shortage are many, for example, the government adopted a complicated structure with multiple rates.
  - The government has not been able to fix the filing system, which has affected compliance and collection system.
  - Fake invoicing has been a problem.
- Way forward
  - The government should look into simplifying the tax structure.
  - There should be an overhaul of the system as the states cannot be dependent on the compensation from the centre.
  - Bringing the petro products under the ambit of GST.
  - All technical issues in terms of filing should be addressed.

2. RBI sets rules for liquidity scheme (LM 2/7/20)

- As per the government proposal:
  - A Special Purpose Vehicle (SPV) will be set up to manage stressed asset funds where the securities will be guaranteed by the government.
  - The SPV will be issuing securities up to ₹ 30000 Cr which would be purchased by the RBI.
  - This money would be used by the SPV to purchase short term investment grade papers (of duration up to 3 months) from eligible NBFCs and HFCs, thereby providing them with some liquidity.
  - The SPV has been set up by SBI Capital Markets (a unit of SBI).
  - The SPV will be buying commercial papers (CPs), non-convertible debentures (NCDs).
  - It will not be applicable to any paper issued post 30th September.
  - This has been done to avoid a contagion effect. If some of these entities default on their repayment, it could pose systemic risks to the entire financial sector.
- RBI has laid down the eligibility criteria for non-bank financiers and mortgage lenders to utilise a special liquidity scheme that was approved in May by the government.

- To borrow the funds under this scheme, RBI rules mandate that:
  - Non-banking financial companies (NBFCs) and Housing Finance Companies (HFCs) should not be having NPAs of more than 6% as on 31st March 2019.
  - The funds raised under this shall be used solely for the purpose of taking care of existing liabilities (the entities are estimated to be having liabilities of ₹ 65000 to ₹ 75000 Cr between July and September this year).
  - In one of the last two financial years i.e. FY18 and FY19, the company should have made profits.
  - The borrower should not have been reported under SMA-1 or SMA-2 category by any bank in the last one year prior to 1st August 2018 (SMA-0 is for borrowers who have delayed their payments between 0 to 30 days; SMA-1 is for borrowers who have delayed their payments between 31 to 60 days and SMA-2 is for borrowers who have delayed their payments between 61 to 90 days, and after 90 days the asset will be categorised as NPA).
- NBFCs have been facing financial pressures since the default of IL&FS in September 2018.
- Issues:
  - This will only provide temporary relief.
  - Though liability of the government currently is only ₹ 5 Cr (equity contribution to the SPV), there would be contingent liabilities if the guarantees are invoked (contingent liabilities).
  - The model essentially means that it is the money of the RBI which is being used by the government.
  - This may provide some relief to big and medium entities but doubtful in case of smaller ones as there is a condition that the papers should be of investment grade.
  - The deadline must be extended to the end of the current fiscal as the extended lockdown has affected the working of NBFCs.

3. What ails India's model BIT (BL 29/6/20)

- With unprecedented lockdown, economic activity has been disrupted. Experts have warned that India's GDP growth may slip into negative territory for the first time in over 40 years. In addition to this, there has been an impact on the global incomes which means that the demand for Indian exports could be muted.
- The fiscal and monetary policies have been aimed at easing the credit availability and the government is having limited leg space as the revenues have come under a lot of stress. The measures taken are conspicuous by the absence of the reforms which would have put money in the hands of the households (as the households account for around 60% of the aggregate demand). Hence, the extent to which these reforms would help in reviving the economy is uncertain.
- Notwithstanding the call for self-reliance, India should be looking into attracting the FDI coming from China. Indian manufacturing could be improved and the integration into the global supply chains can be done by attracting foreign investments.
- Though India is one of the largest recipients for FDI and has been improving greatly under ease of doing business rankings, the inflow of FDI is just around 2% of the GDP (the equity FDI inflow into India has been much lesser than the remittances).
- One of the reasons for this sub-optimal flow of FDI has been the Bilateral Investment Treaties (BITs). BITs are signed by countries bilaterally to reciprocally protect the interest of the foreign investors, specifying conditions on regulatory oversight and limiting interference with the rights of the foreign investors.
- India signed its first BIT in 1994 with the UK and since then has inked 86 such bilateral treaties, the latest being with Brazil in 2020. BITs have been instrumental in attracting the FDI, a study has shown that the protection and commitment provided under BIT has led to a substantive increase in the inflow of FDI during 2001-2012 period. But various issues such as the imposition of retrospective taxes, cancellation and revocation of spectrum, etc. had led to a review of BITs.
- India framed a new BIT in 2016 and has moved towards a protectionist approach. Since its adoption, it has unilaterally terminated 66 odd BITs between 2016 to 2019 which has sent a negative signal to

the global investors and since then no country has shown any inclination to negotiate under the new model BIT. Since 2016, India has signed just 3 treaties of which none are in force yet.

- Issues with the BIT:
  - Has narrowed the definition of "investment" which would be accorded protection.
  - The foreign investors will have to exhaust the domestic remedies before taking to international arbitration proceedings. The issue with this is that India ranks 163 out of 190 countries in ease of enforcement contracts, and it takes 1445 days and 31% of the claim value for dispute resolution. This does very little to inspire confidence among foreign investors.
- With the recession looming over the Indian economy, the government needs to correct these issues as foreign investors are worried about the safety of their investments, no matter how many more sectors are opened up by the government or schemes launched to promote production.

4. Raising white elephants (BS 30/6/20)

- It's been almost a decade since the launch of WLATMs (White Label ATMs). The performance of this model has not lived up to the expectations.
- Issues:
  - The interchange fees (paid by the card-issuing bank, when its card is used for transactions in ATMs of other banks) has not been revised since 2012.
    - It has to be changed to ₹ 18 from ₹ 15 for cash-based transactions and from ₹ 5 to ₹ 8 in case of non-cash based transactions.
    - This has to be increased as all the other service charges have been raised.
    - This has not been raised as the banks are against it as it will burden them with these charges.
    - Arguments counter to this have been that some of these players also provide facilities under the brown label ATMs (with the signage of the bank) but charge a lower rate per transaction (RPT). Here it is important to note that:
      - In the latter, the ATMs will have the signage of the bank
      - 60% of the card swipes are at bank's own ATM
      - In the case of brown label, the RPT can be earned on all the transactions
  - Poor footfalls
    - Since the WLATMs do not have signage of the bank, the footfalls are less
    - With the emergence of digital payments, footfalls are getting reduced
  - Limits on transactions
    - With a limit on free transactions, customers would be taking out a higher value of withdrawals, this means cash would have to be replaced at shorter intervals, taking the operational costs higher.
    - In the case of WLATMs, there is a need to have 125 transactions per day to make it viable. In urban areas, the number is low with the emergence of digital payment modes and in the case of rural India, operating costs would be much higher.

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