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STIMULUS MEASURES

Is it really a booster dose for the economy?

The best part of these measures is that the government acknowledges the intensity of the problem. However, much more is expected from the government on factor markets reforms for sustainable growth in the medium-term

AS WE NEAR THE end of the second quarter of this financial year (2019-20), it is evident that the Indian economy has expanded at its slowest pace in over six years in the April-June quarter—at 5% against the projected 5.7%—on the back of slowing investment growth and weak consumption demand. The sectors that led to a decline in growth in Q1 in 2019-20 are manufacturing (with a growth of 0.6% vis-à-vis 12.1% in Q1 of 2018-19), agriculture and allied (2% against 5.1% in 2018-19), and construction (5.7% vis-à-vis 9.6% in 2018-19). High-frequency and important indicators such as automobile sales, domestic air traffic and consumer durables are on a continuous downturn, indicating a slowdown in private consumption. The upper-middle class households are holding back given the slowdown and the demand by this section of the population has saturated. With the slowdown of the economy, the growing new middle class is also not spending enough, leading to a decline in demand. Additionally, the uncertainty in trade and investment arising out of the US-China tariff war and the geopolitical issues threatening a stable oil supply weigh down the growth sentiments and business confidence in India.

To pull the economy out from the slowdown, finance minister Nirmala Sitharaman has announced a series of stimulus measures—credit support, tax rebates, support to the MSME sector, FDI reforms with easing norms—to revive economic growth. Some of the positive steps for the MSME sector include pending GST refunds (worth Rs 4,000-5,000 crore) due to MSMEs to be executed within 30 days and all future GST refunds to be paid back within 60 days. Measures for better credit flow to MSMEs and time-bound online tracking of loan applications are welcome steps.

Following the RBI recommendation, the MSME Act has been amended to ensure a single definition of MSMEs based on annual turnover, which will make manufacturing growth-oriented and encourage ease of doing business. Banks will issue improved OTS (one-time settlement) policy and launch check book approach to help MSMEs and retail borrowers settle their over-dues.

In the financial markets domain, Section 56-2B of the Income-tax Act will not be applicable to the registered start-ups, and a dedicated cell will be set up at the Central Board of Direct Taxes (CBDT) to address the tax problems of start-ups, where start-ups could be identified as MSMEs. Although there is nothing directly for the automobile sector—which is one of the major success stories of the Indian economy—the change in the definition of MSMEs would help auto companies, especially the retailers, to avail incentives and benefit from MSME schemes. With better credit facilities (Rs 70,000 crore to the public sector banks for additional credit facilities), more and more MSMEs can get the push in order to contribute to the agricultural sector's revenue.

In continuation of the first set of measures announced on August 23, the finance minister again announced measures on September 14 to boost the economy, mostly focusing on export and housing sectors—including offering credit support of Rs 36,000-68,000 crore in priority sector lending, higher insurance cover for lending working capital for exports, improving technology to reduce the turnaround time for exports, introducing fully electronic refund mechanism for GST and a scheme to replace MEIS for Remission of Duties or Taxes on Export Products (RoDTEP). All these measures will increase liquidity and allow better credit facilities to small and medium exporters. The finance minister also announced a special Rs 10,000 crore fund for last-mile funding for non-NPA and non-NCLT housing projects, and liquidity support of Rs 30,000 crore to HFCs (housing finance companies) to make liquidity available for infrastructure.

The economic stimulus package also includes measures for consolidation and recapitalisation of PSBs. The government has announced an upfront release of Rs 70,000 crore to PSBs for additional credit facilities and plans to release another Rs 5 lakh crore to banks in a phased manner. Consolidation of state-run banks is expected to bring in efficiency, bigger project funding and spur private investment. Over the years, a huge amount of investment is made in technology and compliance, but the return on this investment falls short for smaller banks. Hence, a merger will help PSBs that are sub-par in size. A bigger bank implies more independent decision-making and specialised services. The size and scale help the bank's management not only deal with government, but also carry out faster decision-making and makes them better placed for loan monitoring, overseeing the end-use of funds and better recovery. However, the efficiency of the banking sector depends more on governance reforms in this sector. Better governance including composition of boards, succession planning similar to private sector banks, attracting top-notch GMs and CGMs, and competitive executive compensation are some of the necessary steps.

Measures to pump in liquidity and boost private investment, along with FDI reforms, are expected to turn around the Indian economy in the short-term

The biggest of all recent measures was announced on September 20, where the effective tax rate for the corporate sector has been reduced to 25.2% from 35% including all surcharges. This big move will make the effective tax rate 22-30%, comparable to Asian countries, and will certainly give a lot of relief to companies affected by lack of demand. Further, domestic firms incorporated on or after October 1, 2019, will pay income tax at only 15%. This will encourage firms to invest. Overall, the slashing of the corporate tax rate and lower income tax will boost private investment, which has been slowing down over the last decade, although it has a huge cost to fiscal balance.

All these measures to pump in liquidity and boost private investment, along with FDI reforms, are expected to turn around the Indian economy in the short-term. The best part of these stimulus measures is that the government acknowledges the intensity of the problem. However, much more is expected from the government on factor markets reforms for sustainable growth in the medium-term.