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Demonetization was surgical strike on black money: But failed due to poor implementation

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Objections were made, and rightly too, when higher demonization rupees 500-note was introduced for the first time in the year 1987, followed by re-introduction of rupees-1000 note in the year 2000 after being demonetized in the year 1978. No other advanced or sensible country has currency in units of more than 100 thereby elimination chances of parallel economy of black money through increased currency-circulation because of higher-denomination notes.

But unfortunately, desired effects of a bold and tough decision of demonetization could never be achieved because of poor implementation. It is a fact that issue of notes in denomination of rupees-2000 should have been ideally avoided. But it had to be printed as a short-term measure for urgency of immediate replacing of demonetized currency-notes of rupees 500 and 1000. Even though the government and reserve bank of India (RBI) may never disclose their intention to stop further printing of rupees-2000 notes, yet it is clear by introduction of much-required denomination of rupees-200 notes, that agencies may not be printing ruupees-2000 notes in future.

Disclosure-scheme allowing about 50-percent amount of demonetized currency being credited in accounts of those disclosing, if would have been announced by Prime Minister in his famous speech of 08.11.2016 announcing demonetization, would have been tremendously successful overflowing public-exchequers, and giving tension-free environment to those disclosing. But by the time the scheme was announced, most people with demonetized currency had exchanged their notes on high commission like 30-40 percent which otherwise would have given a net revenue-earning for the government.

It was extremely faulty decision to allow too many Identity (ID) Proofs like Aadhar-Card, Voter-Card, Driving-License, Passport etc for limited exchange of demonetized currency. Professional people took money for standing in long unending queues for exchange of demonetized currency by presenting a new ID every time. People go for voting in one single day without any such long queues. It is a matter of study how and why such long queues were there continuously day and night for so many days when number of banks and post-offices exchanging demonetized currency were multiple times number of polling booths, clearly indicating large-scale manipulation in currency-exchange.

Currency-crunch could and should have been avoided by allowing old demonetized currency being accepted at all authorized centers like Mother dairy boots, Kendriya Bhandaar, Petrol Pumps and others during complete period of demonetization from 08.11.2016 till 31.12.2016. Probability of little misuse could have prevented complete nation standing on roads causing big hardships.

It was not good that central government and Reserve Bank of India (RBI) broke their promises regularly like by not accepting demonetized currency for exchange at RBI till 31.03.2017. Even in later days of December 2016, central government suddenly required banks to ask source of deposit of demonetized currency, though the circular was later withdrawn. Even though big newspaper-advertisements were given that no questioning would be done about source of demonetized currency deposited in banks by an individual upto rupees 2.5 lakhs. Yet later central government changed its mind by requiring deposits above rupees 2 lakhs to be declared in Income-Tax returns. All this gave both central government and RBI bad name of not keeping promise.

Any good effect of demonetization was later undone by removing all restrictions on cash-withdrawals from banks by individuals which were rightly imposed during period of demonetization. There must be cash-withdrawal limit of say rupees 96000 per month from banks by an individual which may be gradually reduced to rupees 50000 per month to effectively check parallel economy of black money, which unfortunately has re-emerged after demonetization. Likewise it is not sensible to raise limit for jewellery-purchase (real and artificial) without PAN-card from earlier rupees 50000 to now rupees 200000.

India: Banking on a New Stimulus Plan

Nov. 7, 2017 ***Since taking office, the prime minister has been using economic measures to consolidate his control.***

By Xander Snyder
GPF

India's central government is taking a bigger role in managing the country's financial system through a new stimulus plan that will inject cash into banks and infrastructure. Because of a growing number of nonperforming loans, over the past several years, India's banks have struggled with both profitability and capital adequacy. NPLs, however, affect not only banks but also the broader economy, since banks must withhold a certain amount of reserve funds as protection against poorly performing assets. As a result, some productive enterprises could have trouble getting access to the credit they need to support their business.

India's new $139 billion stimulus package, announced late last month, aims to address this problem. Roughly $32.5 billion will be spent on bank recapitalization, while the rest will go toward infrastructure. The idea is to provide new capital to banks, which will let them increase lending while bolstering India's economic growth by creating new jobs through infrastructure projects.

It's not intended as a cure-all, but it is a step toward cleaning up bank balance sheets and claiming greater central government oversight over lending practices. It's part of Prime Minister Narendra Modi's attempt to consolidate political powerand assert greater control over the country's economy.

Recapitalization Plan

The bank recapitalization will occur over the next two years and is intended to be "liquidity neutral," meaning that only a small portion of the recapitalization funds will come directly from the Indian government's budget. Of the $32.5 billion slotted for bank financing, about $2.7 billion will come from the 2017-18 budget. (The government already set aside $1.5 billion in the last budget for bank funding.)

Another $8.7 billion will come from the banks selling equity stakes. This may not seem like a bailout, but it is essentially a way of injecting cash into the banking system because many of India's banks are publicly owned and the central government can, therefore, force them to sell equity to raise money. (Though some banks are privately owned, in part or in whole, public-sector banks account for over 70 percent of all assets in the financial system and about 80 percent of all nonperforming assets.)

The remaining $21 billion will be raised through what's called recapitalization bonds. These government-issued bonds will have sovereign credit protection, a huge advantage when credit rating agencies inevitably scrutinize the incremental debt. The government will force banks to purchase these bonds and then will use this money – the banks' own cash – to purchase a greater equity stake in the banks. In the end, the banks will have the same amount of cash but a number of additional government bonds. These new debt securities – assets for the banks – will act as reserves and enable banks to lend out the cash that previously had to be used as reserves.

The government doesn't expect that $32 billion will solve all of India's banking problems, but it has passed other reforms that will work in tandem with this recapitalization plan. In December 2016, it initiated bankruptcy reform that will let banks more easily write down bad loans and take possession of companies that have defaulted. Declaring bankruptcy was previously a far more difficult process and prevented banks from writing off loans that failed to generate a return, forcing them to hold capital in reserve against poor quality or failed assets.

Indian banks have roughly $140 billion in bad loans, substantially more than the total value of this bailout. The official NPL rate provided by the Indian government hovers at about 8 percent of all bank assets, although unofficial estimates have placed it closer to 16 percent. Fitch, a credit rating agency, estimated that roughly $90 billion would be needed to recapitalize the system and bring NPLs to a non-threatening level.

Infrastructure Stimulus

The second part of the government's stimulus package will see $106.5 billion spent over five years on new, productive infrastructure – including 52,000 miles (84,000 kilometers) of new roads – which will help connect disparate and decentralized areas of India, tying them closer to the country's economic hubs.

India's poor infrastructure hinders growth in remote areas. The central government hopes this new infrastructure spending will give the economy, which has stagnated largely due to constrained credit, a much-needed boost while at the same time creating jobs that will support greater consumer spending. In theory, the new infrastructure projects would be self-supporting, generating cash flow on their own so that any loans used to fund them would be paid back and wouldn't contribute to the NPL burden. A number of projects that were funded through the last round of credit extension, however, remain either stalled or abandoned.

Connecting the far-reaching corners of the country through better infrastructure would also give the central government an opportunity to project its power into these areas. Isolation has forced these areas to become fairly independent. In conjunction with the tax reforms it is implementing, India's central government hopes this move will bring a greater portion of the country under its direct purview. Providing access to these areas through transportation infrastructure is key to asserting that control.

Between India's demonetization efforts last year and this new stimulus plan, it's clear that Modi believes he can achieve centralization through economic reforms. What is less clear is whether these measures will work, and whether he'll be forced to conceive of even more ways to intervene in the economy to achieve his broader goals.

MORE banking reforms coming soon!

November 06, 2017

rediff.com

Some measures announced in Indradhanush -- a 7-point Modi plan to revamp State-owned banks but not completed -- may be taken up again

The finance ministry and the Reserve Bank of India are drawing up a list of reform measures to accompany the recent Rs 2.11 lakh crore (Rs 1.35 trillion) bank recapitalisation plan.

These are being prepared in consultation with banks and might be classified into short-, medium- and long-term measures.

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However, there are indications that some of the measures announced in Indradhanush -- a seven-point plan to revamp State-owned banks but not completed -- might be taken up again.

"If there are some areas which have already been identified and on which action has not been taken, these will be included in the new effort," outgoing finance secretary Ashok Lavasa said.

"It has been made amply clear that injection of capital, by itself, is not enough. It has to be accompanied by several other measures, internal and external, to the banks. I think all these measures have to come in for a healthy turnaround package," Lavasa added.

How these measures would be carried out, whether alongside recapitalisation or after it, is being decided by the government in consultation with the RBI and the banks, he said.

"It is up to the department of financial services to sit with the banks and the RBI and identify what are the measures to be taken in the immediate short term and what are the measures that the banks should initiate for medium and longer terms," Lavasa pointed out.

The Narendra D Modi government had announced Indradhanush in 2015 to recapitalise the lenders based on certain performance parameters.

A Banks Board Bureau was set up, large-scale management changes introduced in public sector banks and steps announced to clean up banks' books, including the setting up of joint lenders' forums and more debt recovery tribunals.

While a number of these steps have been taken, many have floundered.

Experts and banking sector insiders have been doubtful about the effectiveness of these steps.

Government sources said restructuring of banks, including through mergers and reduction of the government's stakes, were pending reforms.

This would happen after the recap as the new bonds would lead to a temporary increase in the Centre's stake in these banks, they said.

Additionally, banks might be asked to write off some of the smaller non-performing loan accounts to clean up their books further.

This would be apart from the cases being referred to the National Companies Law Tribunal under the Insolvency and Bankruptcy Code.

Rs 1.35 trillion bank bailout: 6 Qs for Jaitley

November 06, 2017

rediff.com

Without bringing sound governance and technical capabilities into the RBI's work, injecting new money sets the stage for a next wave of bad behaviour by banks, warns Ajay Shah

Rs 1.35 trillion: This is a large sum of money.

Rs 1.35 trillion is 11 per cent of the net tax revenue of the Union government this year, and 100 per cent of the value for 2002-2003.

The first three phases of the Delhi Metro added up to Rs 0.7 trillion: This decision spends twice this money.

The problems of Indian banking will not end here.

Economic policymakers will be posed with very big decisions on fiscal expenditures to bail out banks in the future also.

What are the principles which help us in making these decisions?

The first question that we should ask is: How badly does India need banking?

There are other countries (the US, the UK, Japan, China) where the banking system is quite large. But in India, banks do not matter that much to the economy: We are a market-dominated economy.

The 2,400 large companies alone have equity market capitalisation of Rs 131 trillion. If we were able to count the value of equity in the remaining firms, it would add up to a lot more.

In contrast, the credit by all banks to all private persons (summing up across firms and individuals) stands at Rs 80 trillion.

Banking is less important to India than is the case elsewhere.

The second question that we should ask is: Do we have policy levers through which the flow of capital through non-bank channels into the economy can be sharply augmented?

In our case, the answer is clearly 'yes'. A great deal is easily done by way of liberalising the equity market, the bond market, foreign capital inflows, NBFCs, fintech, securitisation, etc.

By pressing those levers, we can increase access to capital, and counteract the long winter of bank lending.

The third question that we should ask is: Is the economy at a time when it makes sense for borrowing to rise?

In India today, we are at a momentous change with the implementation of the Insolvency and Bankruptcy Code.

Corporations in India have traditionally been undisciplined and habitually delayed payments. The IBC has empowered a single aggrieved operational creditor or lender or bondholder to initiate the bankruptcy process.

Indian firms now need to up their game: They need to run a tight ship and make all payments on time. This will require reducing leverage.

A decline in leverage for a few years is appropriate, and was going to come about even if there was no banking crisis.

The fourth question that we should ask is: Do we have the fiscal soundness through which increased borrowings can be smoothly achieved?

The answer in India is in the negative. India has chronic fiscal stress and a weak credit rating, and does not have voluntary bond investors who trust Indian fiscal institutions.

Increased indebtedness will not be placidly absorbed, and large increases of debt are unfeasible.

The fifth question that we should ask is: What is the social cost of the last rupee of government expenditure?

In a country with a sound framework for tax policy and tax administration, and with sound techniques in public debt management, the cost to society of an additional Rs 1 of government expenditure proves to be between Rs 1.3 and Rs 1.5.

But in India, given the infirmities of tax policy, tax administration, and debt management, the last additional rupee of government spending comes at a higher cost to society. We estimate this at Rs 3 .

This means that the decision to spend Rs 1.35 trillion imposes a cost upon society of Rs 4 trillion.

We should be stubbornly frugal with public money in India.

The sixth question we should ask is: Why did things go wrong, and are we ensuring they will not go wrong again?

In the case of the banking crisis, this requires bringing sound governance and technical capabilities into the RBI's work on banking regulation and supervision.

If this is not done, injecting new money merely sets the stage for a next wave of bad behaviour by banks.

It was striking to see the stock market respond to the ministry of finance decision with a higher stock price for construction companies and ICICI Bank.

Every discussion on spending taxpayer resources for banks should go with the associated white paper on RBI reforms.

This requires intellectual capabilities -- merging two weak public sector banks to make a big weak public sector bank does not help.

Some people are enthusiastic about the 'big bazookas' which were used by the UK and the US treasuries in the 2008 crisis. It has been suggested that it is a moral obligation for India to put such vast fiscal resources to work for Indian banks.

However, the answers to the six questions, in the US or the UK, were very different. They had big banking systems. They had no headroom to liberalise and thus augment non-bank finance. They were also in a phase where de-leveraging was required.

They had AAA credit ratings, sound public debt management, and could surge debt. Their marginal cost of public funds was about 1.5, reflecting sound frameworks for tax policy, tax administration, and debt management.

Their ministries of finance did not merely put up money; they reformed their financial agencies with a vengeance.

Deep experiential local knowledge is supremely important in fields like economics.

Look back at the UTI crisis.

While taxpayer money was used, this was accompanied by deeper reforms: The UTI Act was repealed, the privatisation process for UTI was begun, and UTI was placed under the regulation of the Securities and Exchange Board of India.

The key persons (Yashwant Sinha, S Narayan, Jaimini Bhagwati, P Chidambaram, U K Sinha, K P Krishnan, M Damodaran) pushed reforms alongside taxpayer money.

That episode was harder as policymakers had to figure out the steps on the fly.

In contrast, today, mature design work of financial sector reforms is at hand, which reduces policy risk.

AIBEA THIS DAY – 11 NOVEMBER	
1956	Indian Bank Employees Union (Karnataka) Foundation day.
1978	Protest Rallies throughout the country by trade Unions against Industrial Relations Bill and amendments to the ID Act.
2008	Unions in Private sector Banks observe demands day on nationalization of Private Banks

AIBEA THIS DAY – 12 NOVEMBER	
1956	8th Annual Conference of All Travancore Cochin Bank Employees' Union, Jacob Thomas and TKV Nair elected President and General Secretary. Organisation changes name to AKBEU.
1964	Trade Union International: Convention of Unions in Banks – Bucharest: Comrade Prabhatkar participates.
1966	Convention of Unions in Associate Banks meets, leading to formation of SSBEA.
1976	15th Conference of Bihar Provincial Bank Employees' Association: Com. P D Singh elected as General Secretary .
2005	AIBEA Office Bearers meeting at Chandigarh

AIBEA THIS DAY – 13 NOVEMBER	
1979	Anti Repression day observed by employees of Punjab & Sind Bank throughout the country.
2002	Com. Tarakeswar meets Smt. Sonia Gandhi and other leaders on AIBEA demands on the health of the industry
2005	5th All India Bank Working Women Conference at Chandigarh Mrs. Girija Vyas Chairperson NCW, Amarjeet Kaur Secretary AITUC