Opinion

FRIDAY, OCTOBER 11, 2019

CHECK MATE

Union Home Minister, Amit Shah

Prime Minister Modi recently returned from the UN, and the entire world is standing by his decision to abrogate Article 370. On the other hand, Pakistan stands alone in a corner

Smart move by RJio, others should have emulated it

It benefits if its customers can pressure Trai to scrap IUC; if that doesn't happen, it benefits from higher revenues

ASKING ITS CUSTOMERS to pay the six-paise per minute interconnect usage charge (IUC) for calls they make to other networks like Bharti Airtel or Vodafone Idea, is a win-win for RJio. If the customers are upset about paying 18 paise for every three-minute call they make and can pressure the telecom regulator (Trai) to scrap the IUC, RJio benefits as its customers make around twice as many calls as they receive from other networks. Since its launch in September 2016, RJio has paid other mobile phone firms ₹13,500 crore as IUC charges, but has not asked subscribers to pay for this since its USP was the free calls as long as customers paid it for using data; under Trai rules, each time a call is made to another network, an IUC charge must be paid. By asking subscribers to pay the IUC, RJio is painting Bharti Airtel and Vodafone Idea as the villains; interestingly, when the IUC was a higher 14 paise per minute at the time RJio began its services, it never charged customers for this.

If, on the other hand, Trai doesn't scrap the IUC—as per its original plan, this was to be done by January 1, 2020—RJio will get a 10-12% increase over what the subscribers pay it right now, and that will help improve its profitability considerably. And, since RJio has said it will compensate its customers for this IUC-charge by giving them extra data on their current plans, this ensures its customer-friendly image doesn't suffer; if RJio's network is relatively uncongested, the costs of giving customers more data won't cost that much extra either.

While it is not clear whether Trai will scrap the IUC, chances are it won't since most telcos are in very poor financial shape. Indeed, till the last quarter, industry revenues have been falling for several years, and this has put at risk not just around ₹2.5 lakh crore owed to banks but also the ₹3 lakh crore or so of spectrum dues to the government—telcos paid an upfront fees, and most auctions allowed them to pay the balance in equal installments after an initial moratorium. Indeed, there have been no auctions for the last three years due to industry finances being a mess.

What is surprising is that none of the legacy telcos have come up with an equally smart strategy as RJio's. Around 400 million telecom subscribers are still on the old 2G networks and while a large number of them don't pay much, telcos still made some money via the IUC since, whenever these customers got a call, an IUC was paid by the calling party. So, when Trai cut the IUC from 14 paise per minute to six paise in 2017, the older telcos should have started cutting off the lower-paying subscribers and blamed the Trai for this; they have started doing this now, but without blaming Trai. While Trai justified the IUC-cut by using the operating costs of IP-based networks, like those of RJio, which are much lower than those of legacy networks, it never thought of how poor subscribers with basic 2G phones would move to 4G networks that both required more expensive phones—RJio heavily subsidised it to choking its feature phone to make it more affordable—and higher billing plans. While it is understandable that telcos wouldn't want to take on the regulator so openly, certainly the government needed to ask the regulator to justify the cut since it was always obvious it would result in, eventually, poorer customers getting shut off from telecom networks; given 4G customers pay 3-4 times what 2G ones do, even the older telcos are quite happy to move to 4G networks.

RBI right on Indiabulls-LVB

But it needs to push mergers of weak banks quickly

IT IS REALLY not much of a surprise that RBI has turned down the proposal to amalgamate Lakshmi Vilas Bank and Indiabulls Housing Finance. To be sure, the rationale for the merger sounded good: each had its frailties, but the strategy was that the cheap deposits from one would help fund the loans of the other, to create a business with scale. However, allowing promoters connected with the real estate business—especially the commercial piece—to enter the banking sector is not a good idea. This was the central bank's philosophy even when the guidelines for new banking licences were announced in 2013 and the reason why many business groups didn't bag one. Since then, promoters with large financial exposures to the real estate sector have entered the financial services space and tried to make a back-door entry into banking, but these attempts were nipped in the bud.

There are those who argue, however, that the financial markets may just have turned a little more vulnerable to defaults; the BankNifty tumbled 770 points on Thursday as investors worried about how Indiabulls would make ends meet. The big concern is that it owes banks a lot of money, which constitute a big chunk of its long-term borrowings of around ₹1 lakh crore at the end of March 2019. Refinancing loans in this tight-liquidity and risk-averse environment is going to be a big challenge. The banks may claim their loans to Indiabulls are backed by assets, but we know how fast the value of some of these assets can depreciate in a jittery market such as today's. Analysts have pointed out that Indiabulls's exposures to developer funding as also loans against property are somewhat troubling. Therefore, the regulator must ask Indiabulls to deleverage quickly by selling assets.

Indeed, given how growth seems to be stalling and credit offtake is turning negative, it won't hurt to initiate some restructuring of the financial system. There is now definitely a case for greater consolidation with the larger and stronger private sector banks taking over smaller and somewhat fragile lenders—whether banks or even NBFCs—provided the latter have no exposure to commercial real estate and provided the promoters are asked to go. It might seem the central bank is being harsh in not giving smaller banks more time to stabilise their operations but we simply cannot afford another default post IL&FS and DHFL because the risk averseness of lenders is choking the flow of credit. Some merger moves need to be initiated now before any more lenders fail. And the regulator must keep a watch on how NBFCs are raising resources to make sure they are not endangering the system.

HealingMINDS

A new survey on mental health highlights the acute lack of awareness about mental health in the country

IF THE FINDINGS of National Mental Health Survey released a few years ago were not worrying enough—the study found that over 150 million patients were in need of active intervention—a new study by Cosmos Institute of Mental Health and Behavioural Sciences and World Federation of Mental Health shows that India accounts for 28% of the global suicides. According to a *Times of India* report, the study covering 10,233 individuals in 175 districts of seven north Indian states found that nearly half of the people were not aware of mental health issues and had no access to mental health facility. While the good part was increased use of technology to disseminate information and provide mental healthcare—87% seemed to favour use of mobile apps and telemedicine—given the high costs, it is possible that it may not be affordable for many in the country. Costs of treatment was listed as a significant deterrent, with 80% reporting that they did not have health insurance or did not know whether a health insurance plan covered mental health. An investigation by *News-Minute* found that despite Insurance Regulatory and Development Authority of India making it mandatory for insurance companies to include mental illnesses in their offerings, not many have done this.

Although the government launched the National Mental Health Porgramme in 1982, little has been done to address the problem. The aim was to bring mental health service to each district, but that hasn't happened. While the government passed the Mental Health Care Act, 2017, only 19 states have formed a board in compliance with the regulations. Unlike physical illnesses, there is a stigma attached to mental illness, which needs to be addressed for any effective care to take place. With more students and youth exhibiting signs of depression, there is a need to spread awareness about mental health campaigns—a 2010 *Lancet* study found that interventions across 10 European countries led to reduction in suicidal rates and ideas among adolescents.

REVIVING GROWTH

INCOME TAX RATE CUTS SHOULD COME ONLY IF DIWALI DEMAND IS WEAK, THERE IS WEAK RATE-CUT TRANSMISSION BY BANKS AND GOVT FINDS WAYS TO FUND THE CORP TAX RATE CUT

What could spur income tax rate cuts

INDRANIL SEN GUPTA & AASTHA GUDWANI

Sen Gupta is Chief India economist, and Gudwani is India economist, BofA Merrill Lynch. *Views are personal*

CAN THE UNION government cut income tax rates too as some media reports suggest? We think that the bar is pretty high, despite the recent Direct Tax Code report recommending it. Its new tax slabs, as reported in the media, would likely cost ₹1750bn/$25bn/0.8% of GDP, a top 0.7% of GDP released by September's corporate tax rate cut. There is no doubt that a demand-side measure, like the income tax cut, has a more immediate growth impact than a supply-side measure like the corporate tax rate cut, in our view. Along with RBI measures, this would help to defuse the 2018 liquidity crunch that has pushed up lending rates and hurt demand. On our part, we see three pre-conditions for Delhi to cut income tax rates now: 1) muted Diwali festival demand; 2) banks not passing on RBI rate cuts even after linking retail/SME loans (~40% of bank book) to external benchmarks like the RBI repo rate; and 3) greater comfort about funding the fiscal gap. This could come from the ability to step up RBI OMO if FPI flows do not revive or quick privatisation. On balance, we expect the RBI MPC to cut 25bps on December 5, pause as growth/inflation goes up on base effects, and if global growth slows, cut another 40bps to 4.5% by September.

Income tax cut directly spurs demand

The recent Direct Tax Code has proposed cuts in both income and corporate tax rates. After September's substantial corporate tax rate cut, media reports suggest that Delhi can cut income tax rates as well. We estimate that the Direct Tax Code's new income tax slabs, as reported in the media, will likely cost ₹1,750bn/$25bn/0.8% of GDP. ₹1,000bn will be borne by the Centre and ₹750bn by states in line with the 58:42 devolution ratio. The corporate tax rate cut that could take 2-3 years to take effect. Along with RBI easing, income tax cut would help to defuse the 2018 liquidity crunch that has pushed up lending rates and hurt demand. While the corporate tax rate cut should theoretically spur investment, businesses will expand capacity only if they see demand picking up.

Pre-conditions: weak Diwali, sticky lending rates, RBI OMO

Muted Diwali festival demand: Investors should track retail sales into the October 27 Diwali festival. Our auto analyst expects multiple discount schemes to sell passenger vehicles and two-wheelers in the festive season. Our consumer analyst also expects consumer companies to offer promotion schemes.

Weak transmission even after external benchmarks: We think Delhi will look to cut income tax rates now if banks do not pass on the 25bps October 4 RBI rate cut even after linking retail/SME loans (~40% of bank book) to external benchmarks like the RBI repo rate. Media reports suggest that some banks are already reducing lending rates.

Funding corporate rate tax cut: A quick income tax rate cut would likely be feasible only if Delhi gets comfort about financing the corporate tax rate cut that should lead to fiscal slippage of 50bps of GDP. Besides privatisation, this can take 2 forms: *Step up in RBI OMO if FPI flows do not revive.* FPI inflows, at $2.5bn FYTD, are running well below $12.5bn FY20 BofAMLe. *Use of RBI surplus capital:* The MoF could meet the fiscal gap utilising RBI's surplus capital (₹520bn) identified by the Jalan committee and interim dividend.

Edited excerpts from BofAML's 3 pre-conditions for income tax rate cuts (October 10, 2019)

Income tax cut will push the Centre's fiscal deficit to 4+% of GDP

Item (₹ bn)	FY18 Actuals	FY19 BE	FY19 RE	FY19 Prov	FY20 BE	FY20#	FY20 BofAMLe*	FY20 yoy	FY20# y-o-y	FY20 BofAMLe*
1. Revenue receipts	14,352	17,257	17,297	15,631	19,627	16,408	15,393	13.50%	5.00%	-1.50%
Tax revenue	12,425	14,806	14,844	13,169	16,495	13,908	12,893	11.10%	5.60%	-2.10%
Non-tax revenue	1,927	2,451	2,453	2,462	3,131	2,500	2,500	27.60%	1.50%	1.50%
2. Capital receipts	1,156	922	932	1,028	1,198	1,100	1,100	28.50%	7.00%	7.00%
2.1 Recovery of loans	156	122	132	178	148	200	200	12.10%	12.40%	12.40%
2.2 Other receipts	1,000	800	800	850	1,050	900	900	31.30%	5.90%	5.90%
3.Total receipts (1+2)	15,508	18,179	18,229	16,660	20,825	17,508	16,493	14.20%	5.10%	-1.00%
4. Revenue expenditure	18,788	21,418	21,406	20,084	24,479	22,496	22,496	14.40%	12.00%	12.00%
of which, interest payments	5,290	5,758	5,758	5,826	6,604	5,900	5,900	14.70%	1.30%	1.30%
1.2 of which: Oil Subsidy	275	249	244		249	400	400	2.10%		
5. Capital expenditure	2,631	3,004	3,166	3,030	3,385	2,890	2,890	6.90%	-4.60%	-4.60%
6. Total expenditure (4+5)	21,420	24,422	24,572	23,114	27,864	25,386	25,386	13.40%	9.80%	9.80%
7. Gross fiscal deficit % of GDP	5,911	6,243	6,344	6,453	7,037	7,878	8,893			
8. Gross fiscal deficit	3.5	3.3	3.4	3.4	3.3	3.8	4.3			

*(all fiscal stimulus)#BofAMLe Source: BofA Merrill Lynch Global Research estimates, Ministry of Finance

Rescuing India's economy

Instead of engineering a growth acceleration to go with a demographic dividend, policymakers have allowed growth to slow

NIRVIKAR SINGH

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THE INDIAN ECONOMY is in a very difficult position. Instead of engineering a growth acceleration to go with a demographic dividend, policymakers have allowed growth to slow dangerously, with underlying causes that can lead to long-term harm. The most severe problem lies in the financial sector. Financial intermediation is meant to channel funds from savers to investors. The investors are supposed to put the money to productive use. This generates returns for investors and savers, and overall economic growth.

When the global economy was booming, India also grew rapidly, and saving and investment rates went up, supporting that growth. When the financial crisis hit, like most countries (developed or developing), India injected fiscal and monetary stimulus to ward off a depression. But, this allowed a situation where a lack of structural reforms meant that savings were going more and more to speculative or unproductive investments (or simply being effectively stolen).

What we are seeing now is a wave after wave of problems associated with a speculative boom gone awry. First, it showed up in the banking sector, then in non-bank financial companies, and most lately in cooperative banks. There is plenty of blame to go around for this situation: politicians who are corrupt and lack knowledge, or are focused on their own power; bureaucrats share the same traits; regulators are out of their depth in a complex modern economy; and economists know less than they admit.

But rather than spending time at pointing fingers, we should focus on remedies. The situation is dire enough that this should be thought of as a rescue operation. The broad contours are easy enough to lay out, but turning those into detailed, coherent, well-implemented policies will be a challenge, as it always has been in India. The biggest priority is a clean up of the financial sector. An overhang of bad debt can kill growth for many years. Just look at Japan. More focus, attention, expertise and resources need to be devoted to this ongoing task.

Second, clean up needs to be accompanied by structural reforms. Too many financial institutions in India are poorly structured, poorly managed, poorly regulated. Fixing this will be a Herculean task. Structural reforms create losers and they resist those changes, but the danger of extreme outcomes can help to concentrate everyone on minimising the pain. Of course, sometimes an outsider has to make the tough decisions. The additional cost of bringing in expertise is trivial compared to the potential economic damage of a financial standstill. The regulators really need to step up here, since the problems have arisen because of their failures as well.

With respect to demand and growth, consumption and investment are the major components of demand. There is a chicken and egg problem here. If households are not spending, then firms have no incentive to invest, especially if they already have too much capacity. The government has given tax breaks to households and firms, but directly putting money into consumer pockets is needed. Rural work programmes are a relatively inefficient way to do this, but putting money into all the new rural bank accounts that have been created might help.

What happens to inflation and the fiscal deficit? In retrospect, the inflation hawks seem to have missed the signs of a downturn. Monetary policy stayed tight long enough to crush high inflation expectations, but too long, given all else that was going on. Aggressive monetary easing, as is going on, will help, but it has its own problems, since it hurts savers, and doesn't necessarily increase borrowing and investment when balance sheets are bad and uncertainty is high.

The biggest mistake has been a fiscal responsibility framework that neglects the business cycle and the possibility of severe downturns. The government should be less focused on fiscal deficit targets in the short run, and should not try to pretend they are being met by creating over optimistic projections. In all of this, the failure of economists to provide robust and reliable models of the behaviour of India's macroeconomy is striking.

The government has a perennial problem of failure to raise adequate tax revenues. Periodically, it resorts to "tax terrorism," which only creates more uncertainty and damages growth. A programme of improving the tax structure and administration from centre down to states, cities and villages needs to be implemented to address this problem.

> The government has a perennial problem of failure to raise adequate tax revenues. Periodically, it resorts to "tax terrorism," which only creates more uncertainty and damages growth

Meanwhile serious privatisation is an obvious and necessary step to reduce one aspect of the government's own wastefulness.

In 1991, India faced a severe crisis that triggered major reforms. Those reforms would have been politically difficult otherwise, but were easy to conceptualise and implement, since they involved removing controls that were strangling economic growth. The problem had been brewing since the late 1980s, and smaller efforts at reform had been made. Now the government has to conceive, prioritise and implement more complex reforms, which involve improving the quality of many public institutions. Its recently won robust parliamentary majority give it political room to do so. It will be interesting to see if it can, and will assemble the varied expertise and knowledge needed to rescue India's economy before things get even worse.

LETTERS TO THE EDITOR

Millennials, get a thunder

While the subject that radical climate-activists across the globe, have set the right precedent, remains debatable—it is more important to focus on the message being rendered, than its delivery. Renowned leaders, participating in regular/ad-hoc climate-change conferences and discussion forums, are expected to prioritise the implementation of key initiatives as well, in order to combat the growing risks. Proactiveness and lateral-thinking is mandatory, when it comes to human-life, who bear the brunt of floods/cyclones, poor air-quality, deforestation and forest-fires; time and again. Despite huge technological-advancement and global-innovation, the past decade has witnessed an alarming-rise in levels of greenhouse gases, primarily on account of increased fuel-combustion and industrial activities. Awareness and preventive measures are pre-requisites to surmount the risk. Besides, global warming or excessive drought, concerns are mounting over glacier melt-downs, rise in sea-levels and violent tropical-storms too. It is necessary to act in time and prevent toxic-emissions, drastic climatic-changes—instead of blaming fluctuations in sun's heat, variation in ocean-currents, questionable measurements, faulty climate-models or misleading scientific-concepts. Counting merely on cyclical processes to ensure re-absorption of pollutants/emissions by the water-bodies and carbon-sink forests; won't serve the larger-cause. The negative impact on agriculture, health, economy and environment has already started to outweigh the positives. Increasing oxygen-poor ocean-zones, carbon-dioxide release by rainforests, loss of life due to heatwaves/extreme temperatures, de-growth in crop-yield/soil-productivity and extinction of rare species—rings an alarm bell, loud enough.

— Girish Lalwani, New Delhi

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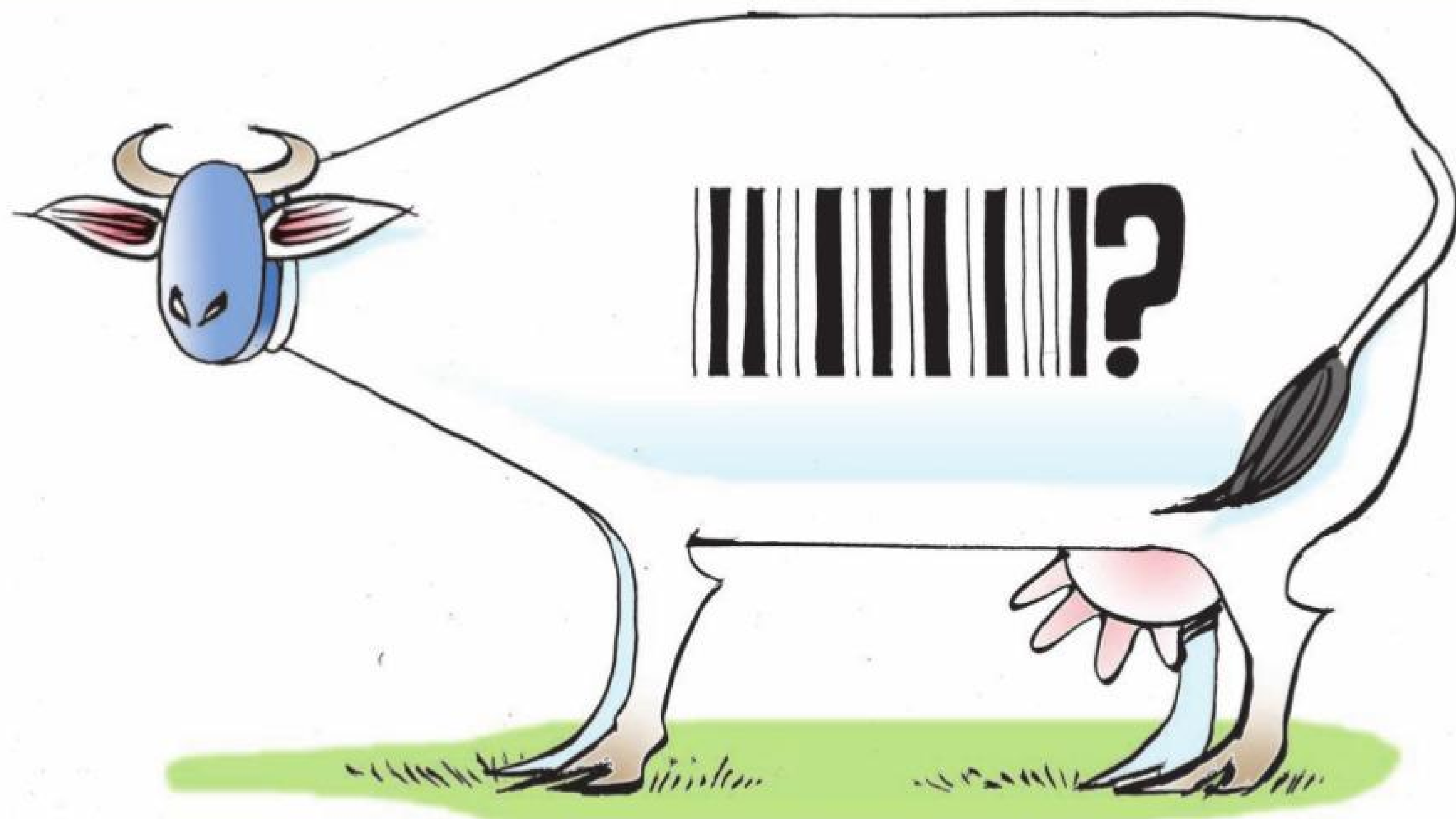

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RCEP CHURN

Protecting Indian dairy from itself

Both cooperatives and private dairies should participate equally in policy conversations. However, a handful of large cooperatives command asymmetric policy clout stemming from large production volumes. This is problematic

INDIA'S LARGEST DAIRY cooperatives have resisted free trade agreements (FTAs) with countries such as New Zealand and trade blocs like the EU in the past, and are staunch opponents to the proposed Regional Comprehensive Economic Partnership (RCEP). The RCEP is an imminent FTA between 16 countries including India, China, Australia, New Zealand, Japan South Korea and members of the Association of Southeast Asian Nations (ASEAN). The RCEP will cover several economic sectors, however, concerns around dairy imports are key to India's strategic calculus.

India accounts for a fifth of global milk production but holds a negligible market share of global dairy exports. Conversely, most RCEP countries are import dependent, making the combined dairy market ripe for Indian exports, that is if the production capabilities in the country were to mature in the future. However, large dairy cooperatives in India seem to fear a narrowing of their domestic market share to high value imports from New Zealand and Australia; and, therefore, seem far from prepared to face competition in potentially lucrative export markets such as China, Japan and South Korea.

India's self-sufficiency in milk production is the result of an overall focus on increasing agricultural production following Independence. 'Operation Flood' which played a catalytic role in dairy development, was akin to the Green Revolution in many ways. Input costs were indirectly controlled through state-supported cooperatives like Amul, and competing imports were banned outright. The political will of leaders like Lal Bahadur Shastri complemented the vision of technocrats like Amul's Verghese Kurien, and created perfect conditions for boosting milk production. Unfortunately, this initial production focus has hardwired rigidities that are hard to shake off.

Consider some takeaways from the National Action Plan for Dairy Development prepared by the government in 2018, in relation to the RCEP debate. The plan is unequivocal on two fronts. India's cattle numbers cannot increase substantially, chiefly because of the immense ecological pressure from water-use and cattle-feed. This puts the onus on improved productivity to expand future production. Additionally, less than half of the marketable production surplus is handled by the organised sector. Cooperatives and private dairies share this organised sector equally, and must, therefore, share responsibilities for addressing the productivity gap.

Thus, both cooperatives and private dairies should participate equally in policy conversations. However, a handful of large cooperatives command asymmetric policy clout stemming from large production volumes. This is problematic on three counts.

First, private sector dairies would undoubtedly benefit from an FTA if it leads to commercially meaningful opportunities for investors in the dairy value chain—particularly at the higher end—in differentiated products like cheese. Private dairies have built their processing capacities much faster than cooperatives despite their first-mover advantage. Global dairy majors like Danone and Lactalis consequently invested in mid-sized and large dairies in India. The market access provided by RCEP could be used to position India as a milk processing hub for Asia. And, at a time when domestic investments are waning across all segments of the economy, the RCEP would be a boon to private dairies. Low private sector awareness and lack of effort by state institutions to bridge such knowledge gaps, mean that the private sector has no real voice.

India has problems that go beyond RCEP, it needs to explore why the private sector is mute in FTA discussions and why cooperatives inevitably become political

Second, large cooperatives naturally attract politicians because of their scale and influence. Take Amul as an example—which sits atop 18 milk unions and where most union appointments are political. Congress dominated the appointments of union heads until the mid 2000s when the BJP began to wrest control. This inevitable political interest in large milk cooperatives generates perverse economic incentives. For instance, milk prices are often suppressed before elections to keep consumers happy, even if market dynamics dictate otherwise.

Similarly, many cooperatives siphon off milk to private processors, while enjoying political patronage and protection. This is akin to pilferage of Food Corporation of India stocks wherein cereals are bought by agents of the state at Minimum Support Prices, and then illegally sold to private food processors for a song.

Last, the unit economics of most Indian dairies make little sense. According to the Food and Agriculture Organisation, the global average dairy herd size is 2.4 and according to the National Dairy Development Board, Indian cows average 3 litres of yield. Mother dairy sells one litre of milk for around ₹44. Since the strength of the cooperative narrative is devolution of profits to the producer, let's assume full transfer from consumer to producer per litre of milk sold. Feeding bovines typically accounts for 70% of the price at which milk is procured by cooperatives. This leaves the producer with around ₹100 in hand, which is also optimistic given all liberal assumptions made here.

In fact, the National Action Plan estimates monthly average producer income to be ₹516 per month! This is roughly equivalent to the daily minimum wages prescribed for unskilled workers in the National Capital Territory of Delhi. The representatives of large cooperatives defend these paltry earnings of their producers.

In 1988, during a speech at the 'Shastri Indo-Canadian Institute', Verghese Kurien stated that "there is plenty of room for competition and our only request is that it be a fair competition". Twenty years on, it seems we are still trying to grapple with this idea of fairness. Whether or not India joins the RCEP and accedes to demands from competing dairy powerhouses is almost a secondary question. We should first explore the reasons why most of the private sector is always mute in FTA discussions, why cooperatives inevitably become political, and why we are all comfortable with the average dairy farmer earning less than the cost of coffee at hotels where governments typically conduct RCEP negotiations.

ONE IN THE AI

US blacklists China's AI firms

The move, linked to repression in Xinjiang, strikes at the heart of China's technological ambitions

FOR TWO YEARS reports of mass incarceration have seeped out of the remote Chinese province of Xinjiang. Over 1m people, mainly Uighurs and other Muslim minorities, have been locked up in camps. Millions more live under a police state. American officials, fearful of upending trade negotiations, have dithered over a response. On October 7th, three days ahead of the 13th round of talks, they put their foot down. The Commerce Department banned American firms from selling software and hardware to 20 public-security organs. It also blacklisted eight Chinese companies whose products, it says, facilitate the Orwellian surveillance in Xinjiang.

The ban hits at the heart of China's artificial-intelligence (AI) ambitions. The eight firms include startups working on facial recognition (Megvii, SenseTime, Yitu), voice recognition (iFlytek), digital forensics (Xiamen Meiya Pico) and chip-making gear (Yixin), as well as Shenzhen-listed makers of video-surveillance kit (Hikvision and Dahua). Together they are worth around $75bn. In August Megvii and Yitu were designated as national champions.

How much will it hurt? Most of the firms are probably using American components. The 10% post-ban drop in the share price of Ambarella, an American maker of computer-vision chips, suggests that the Chinese are important customers. Huawei, a telecoms giant on the same blacklist since May over concerns that Chinese spooks use its gear to spy on America, expects to lose $10bn in revenues this year, mainly from its smartphone business.

Things may not be so bad for the octet, at least in the short run. They have been hoarding parts in anticipation of a ban and have sought other suppliers. Since the array of components they require is tiny next to Huawei's needs, they can buy essential ones on secondary markets. Jefferies, a bank, reckons domestic chipmakers such as DeePhi, Horizon and HiSilicon, an arm of Huawei, can make up any shortfall.

The firms were quick to downplay the ban's impact on their business. Xiamen Meiya Pico said its hardware was mostly home-grown and "highly replaceable". iFlytek said the restrictions would have "no significant impact" on daily operations. Most cameras built by Hikvision and Dahua are thought not to contain sophisticated American innards. For the "very small fraction" that cannot be substituted, Hikvision said it would ask clients to source and integrate the parts themselves.

The eight firms include startups working on facial & voice recognition, digital forensics, chipmakers, and video-surveillance firms. Together they are worth around $75bn

The ban's longer-term effects look hazier. It has spooked the firms' Western research partners, whose help they rely on to develop cutting-edge technology. On October 9 the Massachusetts Institute of Technology, which cut ties with Huawei earlier this year, said it was reviewing those with SenseTime. American suppliers who lobbied their government to keep selling to Huawei may recoil at defending firms suspected of aiding human-rights abuses.

Foreign customers and investors may be put off, too. Over a quarter of Hikvision's revenues come from abroad. In 2018 it entered the MSCI index of emerging-market stocks. But foreign shareholders are skittish. After selling down its stake UBS, a Swiss bank, is no longer among its ten biggest investors. This week Goldman Sachs, an investment bank, said it was reviewing its role in Megvii's forthcoming flotation in Hong Kong. Megvii insists its blacklisting reflected a "misunderstanding" of the company, which earned 1% of its revenue in Xinjiang last year and requires clients "not to weaponise our technology".

The ban came days before the latest round of trade talks, due on October 10. President Donald Trump may see it as a bargaining chip. Samm Sacks of New America, a think-tank in Washington, discerns darker motives. The blacklisting is "a clear shot across the bow from the decouplers of DC", referring to national-security hawks intent on disentangling the commercial ties that bind the two superpowers. Sure enough, the move prompted China to decry America's "wanton interference" in its internal affairs. It threatened retaliation.

THE ECONOMIST

Beyond monetary and fiscal policy

Bank denationalisation can be a solution to tackle slowdown woes

GURBACHAN SINGH

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TO TACKLE THE economic slowdown, RBI has, in a phased manner, reduced the repo rate to 5.15%. With the mandated inflation target of 4%, the real repo rate stands at 1.15%. Any further cuts will hurt the interest income of depositors including the retirees. In any case, the transmission is quite weak. RBI can only make liquidity available, but cannot ensure lending. So, monetary policy has become quite ineffective. What about the fiscal policy?

The government has made a large cut in the corporate tax rate. It will lose anywhere between ₹63,000 crore to ₹1,45,000 crore of tax revenues annually. Thus, it will be hard to meet the 3.3% fiscal deficit target. If we were to refer to Reinhart and Rogoff's suggested metric deficit to tax ratio instead of the metric deficit to GDP ratio to size up the fiscal condition, the situation is far worse. Also, considerable borrowing has been carried out through public sector undertakings. There are contingent liabilities due to guarantees provided by the GOI. Furthermore, the latter has been using disinvestment proceeds primarily for revenue expenditure. There are difficulties in the finances of the state governments as well.

Given these constraints, it is becoming hard to use an expansionary fiscal policy. The GOI has already violated the spirit of the FRBM Act. Should we now dump the Act itself, as TN Ninan has suggested? That may not be advisable. The FRBM Act has served as a prudential safeguard.

The answer, therefore, lies in the banking policy. Banks despite having deposits, have limited capital. Given the Basel capital adequacy norms, they are constrained. That indicates to a problem of supply of credit. But, do we have enough demand for credit?

During a slowdown the credit market is sluggish. From April-September, 2018 to April-September, 2019, the flow of funds from banks to the commercial sector has collapsed from (+) ₹1,85,083 crore to ₹1,28,760 crore, reflecting a fall of ₹3,13,843 crore. The correlation between economic slowdown and credit is clear, the causality is not. So, does low credit cause a slowdown, or is it the other way round? Let us consider both possibilities. In the first case where low credit causes a slowdown, there is an obvious reason for restoring the supply of credit so that the slowdown is tackled.

But what if the economic slowdown causes low credit? For a given group of borrowers, the demand for credit in a slowdown is indeed less than what it was in normalcy or in times of a boom. This, however, does not imply that there is no demand or even little demand among other groups. We are all familiar with the extent to which there is a sellers' (or lenders') market in so far as credit availability is concerned. Now even if due to an economic slowdown there is less demandthat does not imply thete is little demand for credit. More so when the growth rate of GDP is still positive, even if it is less than 5%.

In fact, many private banks are still lending even in this phase of slowdown. But the public sector banks (PSBs) have, for a while, not been meeting that demand adequately. It can be that they were or still are capital constrained. Alternatively, they are just unwilling to lend. I will come to the latter possibility later. Let us for the moment deal with the issue of capital constraint among the PSBs. The GOI is fiscally constrained and reluctant to recapitalise as and when banks are short of capital. For one, it encourages moral hazard in loss making PSBs. However, it has the fear that if it does not recapitalise, lending will fall and an economic slowdown will result or worsen. So, it eventually tends to give in; in the meantime, there is a slowdown! But what is the way out?

Simply put, the GOI can denationalise the PSBs—in a phased manner, transparently, at a reasonable price, and under the condition that the sale proceeds are used for '*aam aadmi*'. Of course, social and macro-prudential regulation needs to be strengthened so that the objectives of social justice and macro-financial stability can be met through appropriate regulation of banks. There are reasons to believe that the ruling party has enough control or influence in the Parliament to make suitable amendments that pave the way for denationalisation.

The general argument for denationalisation has been well articulated by others like Arvind Panagariya. But how does denationalisation help in dealing with the current slowdown or possible future slowdowns? After denationalisation, it is expected that banks will have less NPAs. They will not be every now and then short of capital, they can meet the Basel norms, and lend on a large scale. The fiscally constrained GOI will not need to recapitalise at any stage, what are now, the PSBs. It is true that this policy suggestion does not rule out the need to recapitalise some bank(s) in an occasional major financial crisis but it does rule out somewhat regular bail-outs of PSBs.

It is true that not all PSBs are constrained by capital adequacy requirements. Some of them are not lending anyway—they are lazy or fearful. It is important to understand the meaning of fear here. What this means is that the managers are fearful that they may be penalised for taking a wrong decision, which they may take if they do not do enough home work in assessment of risk. But this is again basically a case of lazy banking, not quite fearful banking. This is true of not just some PSBs but it applies to even some private banks. How to deal with this issue?

Note that if banks are getting deposits but they are not lending adequately, they are clearly holding excess reserves or government securities. So, this is where we need to find a solution.

We are familiar with a minimum cash reserve ratio (CRR) requirement and a minimum statutory liquidity ratio (SLR) requirement. Now we need another regulation. There should be, as some others including Professor Dasgupta (Dalhousie University) had suggested, a regulation for maximum CRR and maximum SLR as well. The reason is simple. With the new regulation, banks cannot sit on too much liquid assets; they will need to lend more actively (though judiciously). This will avoid negative externalities that take the form of aggravating, if not causing, an economic slowdown.

What about shadow banking and the slowdown? That is a different story.