Interest on Small Savings: A quick rollback

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In one of the quickest rollbacks, the government reversed a move to reduce interest rates on small savings schemes. Restoring the rates through a Twitter message, Finance Minister Nirmala Sitharaman termed the announcement as an “oversight”.

On March 31, 2021, the government declared a severe cut of interest rates on all small savings schemes comprising Public Provident Fund, term deposits and a host of welfare schemes for senior citizens, girl children and farmers. The new rates were to come into effect from April 1, 2021.

These decisions were significant, as the reductions ranged from 40 to 110 basis points across various savings schemes and in the case of the Public Provident Fund, the interest rates touched the lowest point since 1974. The government had declared a drop in small saving rates for the first quarter of the new financial year. It was the second instance that interest rates on small savings instruments were reduced in the past 12 months. Earlier, the government had lowered rates of small savings schemes by 70 to 140 basis points for the April to June quarter of 2020-2021.

Sitharaman mentioned that interest rates of small savings instruments will continue at the rates of 2020-2021 and the orders released by oversight shall be cancelled. It was certainly a sleepless night for many when the government stated the revised rates, but the tweet gave a big relief to many who depend on these savings schemes for survival.

The National Small Savings Fund (NSSF) decides the manner in which deposits from several small schemes credited have to be invested. The NSSF invests the collected funds in special government securities of the centre and states such as oil, food and fertiliser bonds. It has also invested in Food Corporation of India, National Highways Authority of India, Air India, Indian Railway Finance Corporation, Power Finance Corporation and Rural Electrification Corporation. The NSSF have to earn sufficient earnings on its investments to meet its payment obligations. Any shortfall in the returns has to be shouldered by the Union government.

After 2014, states started raising funds from the market rather than borrowing from NSSF. The interest payment outflow in 2019-2020 on small savings under NSSF was approximately Rs 1.11crore, whereas gross deposits gathered in the schemes was around Rs 23.48 crore. It is projected that the interest outflow will rise to about Rs 1.58 crore for 2020-2021, up around 42 percent from 2019-2020.This may be the one of the reasons why the government decided to cut the interest rates sharply.

There are many instances of the casual style in which policy is framed and decisions implemented by the government other than this gaffe. While withdrawing the decision, Sitharaman said that the orders were released by “oversight”. There cannot be a more shocking remark on the decision-making procedure of the government.

Now the question is whose oversight was it? Were the minister and senior representatives in the ministry aware about the effects of the decision on distressed citizens? Were any other choices made in a similar manner? How can a key policy decision be due to “oversight”? If this was so, then what is the punishment that should be meted out?

Many know that the government did not think of the unfavourable effect of its decision on the lives of the vulnerable such as senior citizens, most of whom are dependent on small savings. But it must have been worried about its impact on the recent elections, resulting in a reconsideration of the move.

The government’s so-called concern for the girl child and farmers, which is frequently uttered, was also questioned with the rate cut. The cancellation of the decision revealed cunningness. Moreover, no one will be shocked if the rate cuts returns after the election results. The government may announce the decreased rates again, either over the next couple of months with retrospective effect from April 1, 2021 or in the next quarter beginning July 1.

The rollback gave ample opportunities to Opposition parties to criticise the government. Congress leader Priyanka Gandhi Vadra reportedly said the rollback was election-driven. Yashwant Sinha, who was popularly known as a rollback minister when he was the finance minister in early 2000, was quoted as saying: “I am very sad today. I thought I alone had the monopoly of rollbacks. This government has outdone even me. Labour laws, small savings interests are a couple of examples. Roll back Modi.”

Many industry experts are of the opinion that the relief may only be momentary. Chief Executive Officer of Equirus Wealth Management Ankur Maheshwari said: “The government wants lower interest rates within the economy. The existing rates have been retained for only a quarter, so they may be reconsidered once that period is over, or a little later.” Earlier, the Shyamala Gopinath Committee, an advisory panel set up by the RBI, designed an outline for adopting small-savings rates. According to the framework, the average return on government securities of a comparable maturity should be computed over the previous year and then a 25-basis point spread should be provided above it. Considering this, Chief Financial Planner of Plan Ahead Wealth

Advisors Vishal Dhawan said: “Since a mechanism for aligning small-savings rates with market rates already exists, it is only a matter of time before it is fully implemented.”

As an investor, one cannot do much as the government is expected to declare the cuts over the next few months. Investors should invest in a high-interest-yielding small savings instrument that has a quarterly compounding interest. This will yield high rate of return for at least present quarter, provided the government does not announce the revised rates later with retrospective effect from April 1, 2021. Investors cannot do much for schemes for which the interest rate is compounded annually.

Thus, the reduction is politically motivated and appears to be temporary. If the latest rate reduction was implemented, the most disturbed would be individuals from West Bengal, an election-bound state. The state accounts for 15 percent of total inflows into small savings schemes in 2017-2018, the latest period for which state-wise data is available, according to the National Savings Institute. The state’s population is 7.3 percent of India’s and the remaining states with a same differential are Delhi, Gujarat and Punjab. The government is flush with funds for freebies, which are financed by the class that pays taxes meticulously. Lowering interest rates on small savings will break their backs.

Ours is a savings economy. The government wants to make it a borrowing economy, as in developed nations. However, they have protection grids like unemployment insurance which do not exist in India. People save throughout their lives to get over a bad patch or for retirement. It is these savings that are under assault from the government. Senior citizens and retirees are finding it extremely difficult to uphold their standard of living for no fault of theirs and their savings are fast vanishing. Petrol and diesel prices are spiralling because of extra excise duties and at a time when international prices were dropping.

The government wants only trade and industry to get funds at an economical rate. But the depositors must get a fair rate too. The government should not interfere with the middle class’s superannuation-linked savings, whatever recommendations may be given after a narrow reading of economic theory.