

Jaitley: High interest rates will make Indian economy sluggish

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The Finance Minister said no country can have "a system where lending rates are low but deposit rates are high. The two are interlinked".

New Delhi, Mar 28:

Justifying slashing of interest rate on small saving instruments like Public Provident Fund (PPF), Finance Minister Arun Jaitley today said interest rates in India are "extraordinarily" high and the country risks becoming the most sluggish economy if lending rates continue to rule high.

The existing tax-free interest rate of up to 8.7 per cent on small saving instruments translates into an effective interest of 12-13 per cent on deposits. Correspondingly, the lending rate, which is always a notch above deposits rate, would be 14-15 per cent, he told PTI in an interview here.

"On small savings, India's interest rates are extraordinarily high. And high interest rate prevents growth," he said.

Citing the example of 8.7 per cent tax free interest on PPF investments, he said this translates into an interest rate of 12.5 per cent or 13 per cent including tax benefit. "Where in the world you get 12.5 per cent return of interest? So if deposit rates become 12.5 per cent, then what should lending rates be, 14 to 15 per cent? You will become the most sluggish economy in the world, if lending rates are 14 to 15 per cent," he said.

Jaitley said no country can have "a system where lending rates are low but deposit rates are high. The two are interlinked".

The government had on March 18 announced cut in interest rate on PPF to 8.1 per cent, on Kisan Vikas Patra (KVP) to 7.8 per cent from 8.7 per cent, on girl-child saving, Sukanya Samridhhi Account to 8.6 per cent from 9.2 per cent and senior citizen savings scheme to 8.6 per cent from 9.3 per cent with effect from April 1.

Asked whether the government had taken an unpopular decision, Finance Minister said, "It would be most unpopular decision if India's lending rates were 14 to 15 per cent. To destroy India's economy would be the most unpopular thing to do. Low interest rate in the long run will help everybody."

When a borrower goes to bank for availing home loan, "he should get it at 9 per cent or 15 per cent? Which decision will be unpopular", he asked.

Jaitley said India must have multiple products, giving a range of interest rates. "Even at 8.1 per cent rate is a very good rate of returns, much better than you get anywhere in the world because it is tax free. 8.1 per cent tax free is 12.2 per cent. It's not a small rate of interest.

The government, he said, has to create a mechanism where interest rate becomes more reasonable and those are transmitted by the banks.

“And also don’t forget, the additional argument that you earned 8.7 per cent when inflation was at 11 per cent. When inflation is below 5 per cent, so actually the real rate of interest has gone up,” he said.

Jaitley said the move to tax 60 per cent of withdrawals from Employees Provident Fund (EPF) was aimed at discouraging people from making lump sum withdrawals and spending all the money and it was instead aimed at encouraging them to invest in tax-free pension plans to make India a pensioned society.

The proposal was however withdrawn after widespread criticism. “As India is growing, standards of social security have to increase. And one important component of social security is to make India into a pensioned society,” he said.

He said the original proposal to tax withdrawals from EPF was to converge Employees Provident Fund Organisation (EPFO) and National Pension Scheme (NPS) “into a system where you contribute during your earning period, you get a tax rebate (and) when you retire, you get a big lump sum for your social commitments, tax free and the rest becomes an annuity, the 60 per cent becomes an annuity, which is also tax free.”

“The inheritance to your heirs will also be tax free. The only change I made was to discourage people from spending this entire amount in one go. So if you want to spend the entire amount in one go, as a disincentive you pay tax on the 60 per cent (of it),” he said.

While EPF withdrawals have been made tax-free, the same has now been extended to NPS as well.

“And I do believe that more and more people should continue to switch over to NPS, which means its a system like in any developed country where during your earning career, you contribute, upon retirement you get a lump sum and then you get a monthly pension.

“I do believe retired people should take care of their monthly pension, to that extent I have no regret even about the EPF scheme,” he said.

The minister said many people have told him that it was actually a good scheme.

“After a year I will disclose of how many people have switched over to NPS. And mind you, NPS gives the best returns as compared to any government scheme does,” he said.

(This article was published on March 28, 2016)

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