Opinion

TUESDAY, JANUARY 29, 2019

NATIONAL SECURITY

Narendra Modi, prime minister of India

We are strong proponents of peace but we will not hesitate to take any step for national security. The armed forces have given a clear signal that we don't instigate but if instigated, we don't leave them [enemies of the country]

FM versus CBI says a lot about govt functioning

When Arun Jaitley describes ICICI Bank case as investigative adventurism, imagine the fate of bankers in this and other cases

GIVEN THE CBI'S FIR in the Chanda Kochhar-Videocon case names even former ICICI Bank chairman KV Kamath and current CEO Sandeep Bakhshi—and many more well-known people in the world of finance—as the accused, it is not surprising that finance minister Arun Jaitley should term this 'investigative adventurism' that "involves casting the net too wide, including people with no *mens rea* or even having a common intention to commit an offence". Even as a general rule, as Jaitley suggests, it is a bad idea to name too many people as accused since this shifts the focus of the investigation; there can be little doubt, after all, that Kochhar's business dealings—through her husband—with an industrial group she was giving loans to represented a conflict of interest. The problem with naming all the people the CBI has, on grounds that they were involved in the sanctioning of the loans by ICICI Bank, is the case now moves on to proving their guilt as well. And, given that ICICI Bank was not the only banker, or even the lead banker in a consortium of 20 banks that lent to the Videocon Group, does this mean even the head of SBI—the consortium leader—will be dragged into this and its lending practices questioned?

The problem with Jaitley's statement—that was promptly retweeted by Piyush Goyal who is filling in for Jaitley who is in the US for medical treatment—is that he didn't raise similar objections when well-known PSU bankers were similarly hauled up by the CBI. Indeed, as this newspaper asked when Usha Ananthasubramanian was sacked the day of her retirement for the Nirav Modi scam involving Punjab National Bank, why was no action taken against her predecessors since the scam had been going on for a long time before she took over? Indeed, several PSU bank chiefs whose banks were under a cloud for questionable lending have continued to do well within the government system after this.

At that time, when the investigating authorities were hauling up several PSU bank officials for dodgy loans in the past, this newspaper had argued that, rather than giving the investigating authorities a free hand, it would be better to form a panel which included bankers as well as other professionals of stature to examine the case to determine whether there was a prima facie case that needed further investigation. But with, at one point, the banking secretary directing PSU banks to examine all NPAs of more than ₹50 crore for fraud and involve the enforcement directorate or revenue intelligence, it appeared as if the government was, in Jaitley's words, "relying on presumptions and surmises with no legally admissible evidence". While the number of investigations slowed after that, suggesting wiser counsel prevailed, the fact that Jaitley was constrained to write what he did means that the CBI—or other senior members/officials in the government—did not even consult the finance minister, even if informally, before filing an FIR against so many leading lights of the finance industry. If the CBI had a stellar record in securing convictions, it would be one thing, but given how many of its cases fall flat, as well as the high-profile nature of this case, you would think the evidence would have been vetted by very senior people before proceeding. Sadly, even if the CBI decides not to proceed against all those named—like Kamath and Bakhshi—the damage to their reputations has been done. The fact that such a senior minister has written what he has, of course, has done a lot of damage to the government's reputation.

Early birds aren't flying

Ex-RIL and TCS, profits in sample of 205 firms grew just 0.5%

DESPITE VERY TEMPERED expectations, the Street must be sorely disappointed with the first crop of results for the December quarter earnings season. To be fair, analysts had pencilled in some pressure on operating margins given raw material costs remain elevated and the impact of a softening in commodity prices comes through only with a lag. What they probably hadn't bargained for was significant weakening in consumer demand—in the face of an increase in the prices of goods—and the inability to push through price increases. Maruti Suzuki's five-year low operating profit margin was a shocker, but it is evident from the numbers of efficient retailers such as Avenue Supermarts that consumers are becoming price-conscious. Gross margins at Hindustan Unilever contracted 80 bps y-o-y, and if it managed to post good ebitda margins despite keen competition, it did so by reining in costs—employee costs declined 5% y-o-y while ad-spends were down 50 bps as a share of revenue. At TVS Motors, gross margins fell 310 bps y-o-y due to an increase in raw material costs.

The GDP data shows private consumption has been growing at a very sluggish pace for several quarters now, and anecdotal evidence suggests job creation has been slow, too. Indeed, a glance at Maruti's sales numbers for Q3FY19 shows that growth in urban markets has been flat. While TVS Motors turned in a good performance and was able to take a price hike, analysts point out that, post the implementation of two-wheeler safety norms in April 2019, the company will find it difficult to increase prices and that would put pressure on margins. Costs and competition hit Avenue Supermarts, where ebitda margins slipped 200 bps y-o-y even though revenues were up 33% y-o-y.

If one excludes RIL and TCS from a sample of 205 companies, the net profits are up only 0.25% y-o-y on the back of a growth in sales of 16% y-o-y. Even if one retains TCS and RIL, the growth in profits is just 6% y-o-y and that too with a jump in revenues of 29% y-o-y. To be sure, some consumer-facing companies have done well—Asian Paints, for instance. Larsen & Toubro reported very good numbers on the back of good execution. While a good part of the fall in order inflows—12% y-o-y in Q3FY19—can be attributed to quarterly skews, it is nonetheless true that there may not have been a fall had the private sector been investing more. The IT sector companies have done fairly well, though, with global growth likely to lose momentum—led by slowing growth in the US—there is a good chance of these companies reporting less-than-exciting numbers in 2019-20.

Rameswaram2Rohtak

New data on sex ratio that shows Tamil Nadu worse than Haryana is hard to swallow

THE VITAL STATISTICS of India, released by the office of the Registrar General of India (RGI), claims that the sex ratio at birth in the southern states of the country have precipitously declined. The southern states, hitherto, were known to have maintained impressive sex ratios vis-a-vis the northern states, where levels of social development indicators for females, such as health, female infanticide and literacy have traditionally been lower. However, data collected by the RGI showed that, in 2016, Andhra Pradesh matched a Rajasthan for the worst sex ratio (806), compared to the national average of 877. Karnataka, too, has had a steep fall, from 1,004 in 2007 to 896 in 2016. Tamil Nadu stood fifth from the bottom on the list, with its ratio falling from 935 to 840 over the same period. Against a backdrop of recent interventions at the state level, Haryana, which had recorded the worst SRB (830) in the 2011 Census, has managed to improve its showing (865) in 2016.

Equitable economic and social development, where southern states have historically performed well, does not come about by maintaining such low human development numbers. Only Kerala—which has always fared well as per this report—managed to retain its reputation, with a sex-ratio-at-birth (SRB) of 954 in 2016. However, whether the data in the report is reliable seems to an important question. In 2009, 2010 and 2011, as per previous editions of the *Vital Statistics* report, Assam recorded sex ratios of 931, 1,244, and 920, respectively. Similarly odd numbers have been recorded for Tripura, Arunachal Pradesh and the Andaman & Nicobar Islands. According to *The Times of India*, even a senior census officer in Andhra Pradesh believes that the fall in the SRB in Andhra from 971 in 2015 to 806 in 2016 seem "abnormal". What is more, data from the National Family Health Survey (NFHS) 2015-16, or NFHS-4, do not corroborate the *Vital Statistics* data—Karnataka's SRB was 910, Tamil Nadu's was 954 and Andhra Pradesh's was 914. Also, it is unlikely that in states where the registration of live births is high and abortion rates are relatively lower compared to, say, Chandigarh or Delhi, female infanticide of the scale that would bring down the sex ratio in this manner would be occurring.

ECONOMY OUTLOOK

THERE IS PRACTICALLY NO ROOM TO MANOEUVRE ON THE FISCAL FRONT WHILE THERE IS, AT BEST, LIMITED SCOPE ON MONETARY EASING

Political exigency *vs* economic responsibility

RAJEEV MALIK

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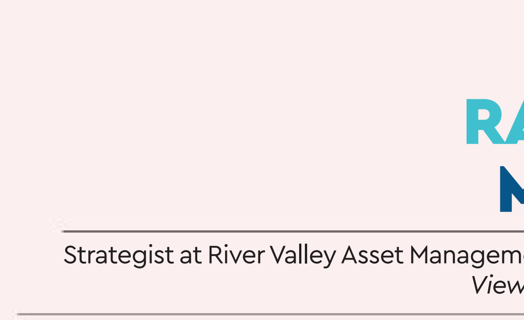
Views are personal



INDIA WATCHERS ARE in for a triple treat in the coming months. This week's Union Budget for 2019-20 will be followed by next week's meeting of the monetary policy committee (MPC). The focus will then shift to the national legislative election, most likely spread over April and May. The Union Budget is the last one by the prime minister Narendra Modi's government while the MPC meeting will be the first to be chaired by the new RBI Governor, Shaktikanta Das. The election outcome, along with its related political arithmetic, is anybody's guess, but the fiscal-monetary mix to be navigated is very much within the control of policymakers.

There is practically no room to manoeuvre on the fiscal front while there is, at best, limited scope on monetary easing. Still, on the fiscal side, we should be prepared for political expediency slightly chipping away at economic responsibility, but a massive assault will be avoided. On the monetary side, the MPC will shift its stance to neutral and also cut the repo rate by 25 bps to 6.25%. Its cautious guidance will effectively signal scope for limited monetary easing, provided the inflation outlook offers that flexibility (which it will, in my view).

The government will likely meet the fiscal deficit of 3.3% of GDP for 2018-19, despite the sizeable shortfall in GST collection. This would be achieved thanks to a sizeable interim dividend from RBI, coupled with the usual cash accounting tricks, including delayed subsidy payments, used by successive governments irrespective of their political hue. RBI's interim dividend isn't unusual, but its size this time could raise eyebrows.

Of course, these gimmicks raise legitimate questions about the quality of the underlying fiscal adjustment, but that is hardly a new issue. The fact of the matter is investors and sovereign credit rating agencies have come to accept the low quality and now often don't even raise these issues when they must. Consider the following: India's reported fiscal deficit of the Central government is understated because it counts divestment and asset sales as revenues instead of as financing items, as is the IMF's best practice.

Also, there has been increasing reliance on off-budget financing of capital expenditure in some sectors, such as roads and railways, via quasi-government entities. Add to these the widening of the state-level fiscal deficit and it is hard not to conclude that the consolidated fiscal picture—which is what matters for macro management—is far from inspiring. The IMF estimates India's general government debt at an elevated 70% of GDP; it has risen since 2014.

Surpassingly, off-budget financing has hardly been as much of a focus as it should when the Union Budgets are announced. For the record, even the MPC and the RBI's financial stability assessment look the other way. The only reason it has captured attention now is because of the recent uncomplimentary observations by the Comptroller and Auditor General.

Investors and sovereign credit rating agencies have come to accept the low fisc quality and don't even raise these issues when they must

For 2019-20, the government will probably peg the fiscal deficit in the range of 3.1-3.3% of GDP (prior target: 3.1%) and reiterate being "firmly" on track to achieve the already announced forecast of 3% in 2020-21. This should keep the MPC satisfied about fiscal consolidation, though recall that achieving the 3% level has been delayed by two years. The marginal slippage shows poor fiscal discipline and is in sync with past behaviour, but is hardly the end of the world. For what it is worth, the officially reported Central fiscal deficit/GDP has shown an improving trajectory, but over a longer time period than initially planned.

The big idea in the Budget 2018-19 will be the announcement of a cash transfer scheme to complement other measures for the distressed agriculture sector. Some measures could be announced before the Budget. It is being widely overlooked that the government doesn't need to compress the role out of the scheme within one fiscal year. Tactically, it'll play up the idea in this Budget and begin its implementation in a small manner, probably by subsuming some subsidies, but complete details will emerge in the full Budget after the general election.

The government has to be extra careful in that the cash transfer scheme cannot be a sizeable additional expenditure on top of the current spending on subsidies. More generally, the initiative follows the pattern of governments committing to recurring expenditure with a silent prayer that revenue collection will improve on a sustained basis to pay for it. This time, a one-off gift, probably spread over a few years, from RBI is awaited to complement traditional revenue sources. The merits, the feasibility and the economic implications of this notwithstanding, the approach is in line with governments' questionable practice of using one-off divestment proceeds to finance recurring spending.

Separately, several factors give the upcoming MPC meeting an exceptional flavour. Firstly, it will be the maiden meeting chaired by Governor Das, who was practically parachuted by the government following the unceremonious exit of his predecessor. Second, the MPC will likely lower its forecast for GDP growth and inflation; thirdly, international crude oil prices remain well below their peak in October; fourthly, the US FOMC is likely done, or is very close to being done, with raising policy rates. Finally, at 2.2% in December, headline CPI inflation has been below the medium-term target of 4% for five consecutive months and will remain so for a few more.

The MPC needs to appreciate that its legally mandated target is headline CPI inflation, not the core measure. Admittedly, the drivers of headline inflation have to be analysed and their sustainability gauged for designing the appropriate policy response. However, there is a perception that the MPC's emphasis on headline versus core inflation flip-flops inconsistently.

To be sure, core inflation has eased but is still uncomfortably high, and the slump in food inflation won't be sustainable over the medium-term. Trend economic growth has edged down in recent years and the near closure of the output gap suggests negligible scope for aggressive monetary easing. However, these don't eliminate the scope for a couple of rate cuts in the very near-term, partly also because real interest rates are high. The MPC is already late in shifting its monetary stance and in cutting rates, in my view.

The MPC should offer insights on the exaggerated impact on core inflation of the narrowly based high inflation in health and education services. The oddity of the latest unexpected—but also narrowly based—jump in rural core inflation despite the pronounced agrarian/rural weakness also warrants an explanation. If high core inflation is because the output gap is closing, why is the magnitude of that impact uncharacteristically large? If not, how reliable is the measure of core inflation for playing an indirect role in calibrating the monetary response function? The MPC has its work cut out.

Artificially low inflation

The solution has to be to ensure that farming is profitable on a sustained basis and has to include a process to balance the terms of trade between farmers and consumers, however politically difficult that may be

JAMAL MECKLAI

CEO of Mecklai Financial

IN 1986 OR 1987, I was young and foolish, and single, which means I was always looking for love. I was in my favourite bar in Bandra one night, drinking a Rosa rum and coke, when, rather surprisingly, two African women walked in and sat at a booth some ways behind me. One of them was the most beautiful woman I had ever seen in my life.

I immediately realised I had to do something, so I took another sip, got to my feet and—cool and casual as ever (ha ha)—wandered over to their table and said, "Excuse me, are you girls from Switzerland"?

They were startled so I quickly slid into the booth opposite the lovely one. And, before I could say anything else, she, looking more at her friend than me, said, "Interest rates in India have been kept artificially low for too long".

I was stunned. I stammered, "That means inflation has been kept artificially high". She nodded in agreement and we all toasted to that. Turned out they were exchange students and had just come out of an economics class where they learned that, in the early days after independence, the government kept interest rates low to promote industrialisation. That it resulted in artificially high inflation, which kept India's poor under the gun, did not seem to have occurred to policymakers at the time. Fortunately, the rest of the evening was far more entertaining and requires an entirely different story.

But, I remembered that evening when I read an article last week describing some research done by ICRIER and the OECD on agricultural policies in India which concluded that "Indian farmers have been 'implicitly taxed' through restrictive marketing and trade policies that have an inbuilt consumer bias of controlling agricultural prices" to the extent of 14% of the value of agricultural output. This worked out to around ₹45 lakh crore over the past 17 years. With agriculture contributing about 15% of GDP, this means that around 2.5% of GDP was unfairly transferred from farmers to consumers—in other words, consumer inflation has been kept artificially low by underpaying farmers. While this is doubtlessly one of the reasons for the urban middle class boom, it is also the key structural reason for rural distress. It also means that interest rates have been artificially low because of this structural control of inflation.

Note that this is the reverse of what prevailed in the early days, when politics was much more defined as nation building. That they got the policies wrong is another issue. Today, politics is its own end and all recent governments have worked to keep the urban consumer happy by keeping prices and interest rates as low as they possibly can. That they got the policies wrong with the farmer ending up paying the cost is, again, another issue.

Except that—and about time, I would say—farmers are now seriously up in arms. We have been hearing about rural distress, farmer suicides and farmers' protests on and off for decades. But this time, it seems different—not only are the protests widespread, they also appear to be more sustained. No doubt this is partly because of the false hope sowed by Modi in his promise to double farmers' incomes. Equally, it may be because today there is almost no segment of society that is happy with the government, so any protest generates both empathy and (at least) moral support.

Politicians—of all stripes—are, of course, clueless. Farm loan waivers are *de rigeur*, even though these do nothing to address the real issue, and work, at best, as a palliative for the farmers, and serve to undermine credit culture. There is talk of a universal basic income, which, while interesting and, perhaps, useful is, again, largely a palliative.

The solution has to be to ensure that farming is profitable on a sustained basis. While there are many apparently open-and-shut ideas for increasing agricultural productivity—larger farm sizes, increased technology use (for both operations and marketing) and accelerating the build-out of irrigation infrastructure—the solution has to include a process to balance the terms of trade between farmers and consumers, however politically difficult that may be.

The next government, whatever shape it takes, would have to construct systems that ensure substantially higher prices to the farmer, which would lead to generally higher rural demand. Urban consumers will be squeezed, which may lead to a decline in savings so financial markets may not be too happy. Inflation will be higher as the implicit subsidy to (mostly) urban consumers will be lifted, and interest rates, too, will be higher (for a given set of global macroeconomic factors). This would also underpin the rupee.

These changes are critical both in terms of fairness and sustainability. And while the transition would be volatile—so what else is new—once the process is tightened, a wide array of efficiencies would kick in and enable growth to rise even faster as agriculture plays a larger role.

LETTERS TO THE EDITOR

In seventh heaven

Novak Djokovic once again proved that he is the master of the craft by bagging the Australian Open title at Melbourne for an unprecedented seventh time. The Serb was in prime form as he swept his opponent Rafael Nadal off his feet in straight sets. Djokovic has now completed a hat-trick of Slams following his wins at Wimbledon and the US Open. With his game on the upswing, the Serb has every chance of bagging the French Open too

— Ravi Chander, Bengaluru

Bharat Ratna

It was surprising that the Bharat Ratna was conferred on former President Pranab Mukherjee. How a self-proclaimed adherent to 'Nehruvian secularism' won favour with a ruling dispensation wedded to the Hindutva ideology defies comprehension. Inevitably, the selection of the elder statesman for the land's highest civilian award became liable to be viewed as the quid pro quo for his visit to the RSS headquarters for which he took a lot of flak from the 'secular camp'. Perhaps it is pertinent to ask whether the award would have been conferred on him had he turned down the RSS' invite to its youth convocation and conclave and refrained from 'legitimising'' the 'cultural' organisation. In a way, the conferment of the award on Pranab Mukherjee revealed the fact that there were and are Congressmen who could have been members of BJP or vice-versa. The significance of the conferment of Bharat Ratna on the much venerated leader along with Nanaji Deshmukh, a proponent of Hindu Right and Bhupen Hazarika, who was an unsuccessful BJP candidate in 2004 Lok Sabha election, is not lost on anybody

— G David Milton, Maruthancode

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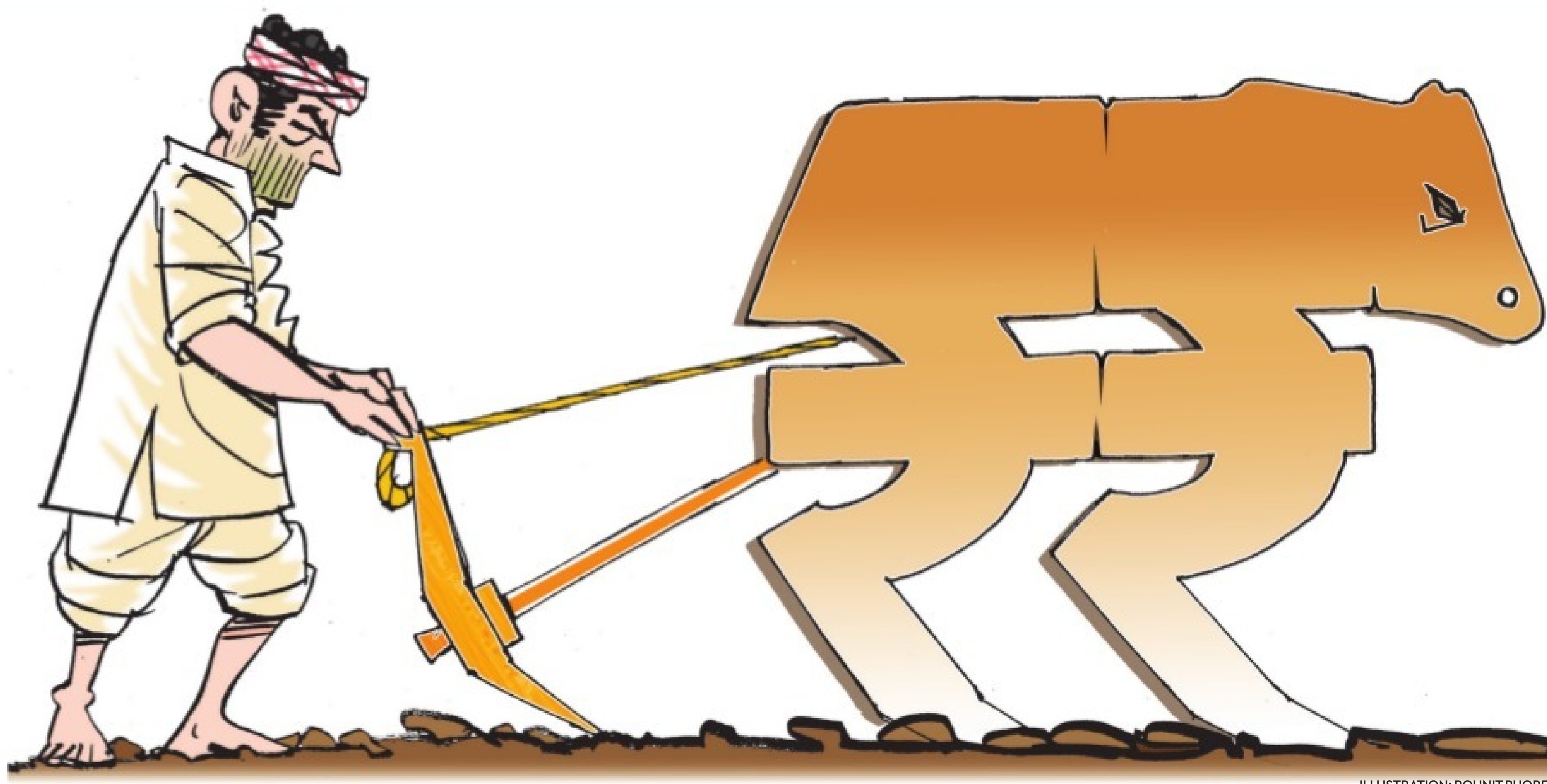
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BUDGET & FARM DISTRESS

Budget 2019 should be a balancing act

Though, in view of the impending elections, the Centre may get tempted to yield to populist demands, it must ensure that reforms whose effects will be visible over the long term are not given the short shrift

BUDGET 2019 IS just few days away, and as expected, farmers and people having interest in the agriculture sector are eagerly hoping to hear some good news. Measures to boost the already troubled agriculture sector are likely to get top priority across the spectrum in view of the sensitivity of Indian agriculture in the political economy. Debates and discussions around issues relating to farm distress throughout the country have heightened the expectations manifold.

In the run-up to the general elections later this year, and following the events in the aftermath of recently-concluded elections in a few states, the attention is on farm-loan waivers. However, agriculture-policy analysts, through empirical evidence, have opined that such 'populist' write-offs could be a temporary redressal, but not a permanent solution. However, considerations of quick political dividends are expected to dominate logical, evidence-based policy guidance, as has happened in the past.

Budget 2018 had a series of measures to boost the agriculture sector. Promising minimum support prices (MSP) of at least 50% higher than the cost of cultivation for major crops (both kharif and rabi) was a landmark decision of the Union government. However, the implementation of this has left much to be desired. The lack of procurement of crops other than paddy, wheat and, to some extent, cotton, is skewed against much-hyped boost to nutri-cereals like sorghum and millets (which saw the highest-ever increase in MSP). Operation Greens (to ensure remunerative prices for perishables like tomatoes, onions and potatoes), another much-hyped scheme, has also not taken off. The GrAM (Grameen Agricultural Markets) initiative, intended to develop and upgrade rural haats to benefit primary producers at the grassroots, has also not percolated to the ground. A slew of measures to promote FPOs and FPCs to de-intermediarise the agri value-chain are yet to bring desired results. Electronically linking the GrAMs to the e-NAM platform, and exempting them from the regulations of APMC Act, hasn't happened, though such a move offers fantastic opportunities to both farmers and consumers/bulk-purchasers. Several announcements, like extending the facility of Kisan Credit Cards (KCC) to fisheries and animal husbandry farmers; setting up a Fisheries and Aquaculture Infrastructure Development Fund (FAIDF) for the fisheries sector and an Animal Husbandry Infrastructure Development Fund (AHIDF) for financing infrastructure requirement of the animal husbandry sector; setting up of state-of-the-art testing facilities in all the 42 Mega Food Parks, etc, are yet to see light of the day. All these are measures in the right direction. Agriculture being a state subject, proactive and enhanced participation of the states continues to be key for the success of any pro-farmer initiative. This must be kept in mind while declaring any stimulus for the agriculture sector in the forthcoming budget.

Going by political sentiments and consequent developments, a populist, pro-farmer budget this time seems a no-brainer. Our sensible expectations, however, would be to revitalise the stressed farm sector for the long-run, while offering 'inevitable' sops as a temporary measure.

Let's discuss the obvious considerations of government of the day (at the Union level as well as in the states) for wooing the farming community, in view of the impending elections. Several studies hold that farm-loan waivers can't be a sustainable solution, given the exclusion of a significant chunk of small and marginal farmers and agricultural labourers; it also puts a heavy burden on the public exchequer even as the money used to cover such waivers could have been invested in raising farm and rural productivity. However, political considerations may dominate logical, economically-sound recommendations, and therefore, an income-support scheme would be seen as advantageous in the medium-term. The KALIA (Krushak Assistance for Livelihood and Income Augmentation) scheme of Odisha that addresses the needs of small and marginal farmers (besides assisting the sharecroppers/lease-holders as well as landless labourers) seems to be an improved version of Telangana's Rhythu Bandhu. While KALIA offers a lump sum amount to small and marginal farmers/agricultural and agricultural labourers/lessee farmers, Rhythu Bandhu gives all farmers (irrespective of land-holding) a direct, per-acre support. Thus, Rhythu Bandhu doesn't directly benefit lessee cultivators or the landless agricultural labourers. Moreover, input subsidies on seeds (from various government schemes) fertilisers and on power/irrigation continue, distorting the core objectives of such direct financial support initiatives.

It would be a challenge for the Union Finance Minister to strike a balance, if at all an income-support scheme for farmers is rolled out pan-India. The bottom-line, however, would be to target existing subsidies, may be through DBT (Direct Benefit Transfer) and phasing out these subsidies with clear-cut policies on entitlements of the benefits (say, basing fertiliser subsidies on farmer-category and soil health). Enhancing the resource-use-efficiency will raise productivity.

In the short- to medium-term, the budget should also focus on building the capacity of institutions for enhanced procurement of the marketable surplus at MSP and also, linking the farmers to markets through alternative mechanisms such as price-deficiency schemes (AASHA has since been launched). Agri-market reforms should be the top the priority, including APMC reforms, promotion of contract farming and increased involvement of private sector in the procurement, processing and agri-logistics in the entire value-chain. High quality-standards for farm produce would raise income of farmers and, therefore, enhanced investments in this area will be rewarding. The Centre has recently declared a farm export policy; it's stability and consistency would definitely be in the interest of those growing agri-commodities that conform to global standards. Necessary amendments in the Essential Commodities Act have often been suggested for positive gains for the farm sector. The Union Budget should focus on measures that will help implementation of already-declared schemes and policies. For example, women self-help groups (WSHGs) that are already active in many parts of the country, could be mobilized in a mission mode to link producers to markets through capacity building, financial literacy and managerial abilities. FPO penetration in rural areas is yet to make headway, and can't bring immediate results everywhere.

Raising farm productivity through traditional technology transfer models has been the strategy of governments over the years. However, increased R&D spending is not commensurate to the desired benchmarks. To realise the goal of Doubling Farmers' Income (DFI) by 2022-23 and to sustain satisfactory levels of agricultural production in a changing-climate scenario, enhanced investment in agricultural research and rural infrastructure is more desirable than ill-targeted input subsidies (including farm loan waivers). Reinvigorating the moribund agricultural extension system with infusion of digital-agriculture could also be a focus area that will have positive impact. Moreover, priority to nutrition-security over the food-security should be clearly addressed through a special mission. Modern agriculture is one of the largest contributors to greenhouse gas emissions and, therefore, a well-designed initiative to sustain agricultural growth in the Anthropocene would make India a global leader in mitigating impacts of climate change. Whether the government pushes various pending reforms measures to boost the farm sector or plays to the gallery for political mileage, or strikes a balance in the interim Budget is something all stakeholders are looking at with much interest. We only wish that the measures that will be eventually announced benefit small and marginal farmers and don't harm the agriculture sector structurally.

E-COMMERCE

Make foreign investors feel welcome

LALIT BHASIN

The author is an advocate, and president, Society of Indian Law Firms

Compliance terms aimed only at foreign-owned firms is discriminatory

THE E-COMMERCE SECTOR has shown immense potential, so the decision of the government to allow FDI in the sector in a phased manner was a welcome move. The online marketplace model, in which FDI is permitted, acts as an aggregation platform for multiple sellers, while especially benefitting small entrepreneurs, who can leverage the platform to scale up their reach and business. It also enables the participation of the next wave of consumers, beyond tier-1 and tier-2 cities, where demand has been hitherto untapped, enabling them to reap the benefits of a competitive marketplace through product variety, affordable prices and better quality.

However, the recent changes in FDI policy norms in e-commerce, as stipulated by Press Note 2 issued on December 26, add a layer of ambiguity to the operations of e-commerce marketplaces under foreign ownership—this doesn't do justice to customers or sellers, and certainly not to foreign players who have made massive investments to further the India growth story. The provisions are clearly intended to influence marketplace operations and commercial dealings. In so doing, they cast doubt on the intent of regulation within the e-commerce space and undercut the government's claims of 'minimum government, maximum governance'. The move flies in the face of the much-vaunted improvement in India's ease of doing business parameters. Policy stability is the foundation for creating a positive investment climate, and no serious host adversely changes the rules of the game for investors after substantive investments have been made.

The Press Note states that an e-commerce marketplace entity cannot mandate a seller to sell any product exclusively on its platform nor have direct equity holdings in vendors whose goods are being sold on the platform. This goes against the first principle of operations in a marketplace—that market-seller relationships are based on commercial viability for both. For smaller sellers, exclusive arrangements are often the first step to access a competitive market. The injunction against exclusive arrangements impacts both the business of small vendors the government wishes to support, and the experience of consumers, besides necessitating expensive changes in e-marketplace operating models.

> If India wishes to draw serious investors, it needs to build the country's reputation with a stable regulatory environment

By far the biggest drawback of the latest fiat is that it gives the affected companies just five weeks to implement these changes. The government has put the onus on e-commerce companies to comply with provisions that will impact sellers and their sourcing channels. Is it fair to expect them to accomplish all this in just five weeks?

Any effort to establish a policy framework in this sector should support the entry and expansion of both domestic and foreign players. A mature e-commerce model can help small producers selling on their platforms to adopt the best practices in technology, stock management and operational efficiency, and thereby build scale and attain business viability.

To add compliance hoops to jump through for foreign-owned enterprises and not domestic ones is discriminatory and undercuts organic growth. With the benefit of their expertise in large-scale e-commerce operations, global companies will substantially raise the bar in supply chain including micro and small retailers, small retailers, agriculture and allied sectors. Thus, it stands to reason that the entry of global retail majors into the Indian market should not be stunted.

India aims to receive $100 billion in FDI in the next two years, and the landmark deals that the e-tail sector has seen recently can be a powerful catalyst for collective growth and value-addition along the entire supply chain through long-term and secure investments.

If India wishes to draw serious investors, it needs to build the country's reputation as the right investment destination with a stable, enabling and predictable regulatory environment. The entry of big and serious players will also give a fillip to initiatives such as Make-in-India, Digital India and Skill India. So, to meet the ambitious goal of becoming a trillion-dollar digital economy by 2025, India should continue to make long-term and serious foreign investors feel welcome.

UNION BUDGET

Focus to be on rural, infra sectors

The interim budget is likely to introduce limited tax changes

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THE GOVERNMENT'S INTERIM budget will be presented against the backdrop of several challenges confronting the economy; additionally, there is a distinct possibility of a slippage in the fiscal deficit for FY19 given the shortfall in indirect tax collections and disinvestment receipts—at least until now.

There is a high likelihood that the fiscal deficit of 3.3% budgeted for FY19 would not be met, even after factoring in the reliance on off-balance sheet funding and the likely roll-over for some of the food and fertiliser subsidies. Consequently, we see limited scope for fiscal consolidation in FY20 as well; while the fiscal deficit target had been set at 3.1% of the GDP for FY20 in the Union Budget of FY19, we expect it to be higher at around 3.3% of GDP. Along with a nominal GDP growth of 11.5%, this would roughly translate into ₹6.9 trillion of deficit in absolute terms. Against this, as repayments falling due in the coming year are ₹2.5 trillion in FY20 (₹1.6 trillion in FY19), market participants will assess the size of the planned market borrowings for FY20, which, along with RBI's monetary stance, would give a sense on the direction in the movement of bond yields.

We do not expect any major changes in indirect tax rates in the interim budget for FY20; in any case, after the implementation of GST, it's the GST Council that decides GST rates for most items. Also, customs duty has been raised on several items post the Union Budget last year. We do not expect reversal of excise duty cut on fuels that was effected late last year. However, minor changes could be possible in personal income tax rates/slabs, which may provide a mild support to consumption.

Farm sector and thereby rural distress is a continuing concern, and to mitigate the same, the government is likely to increase allocations for existing schemes like MGNREGA, Ayushman Bharat, etc, which could result in shifting capital resources from developmental infrastructure to rural spending programmes. Also, there is great anticipation that the government may come up with some sort of income transfer/direct farmer support scheme to support the rural poor. If that were to happen, the manner in which the fiscal space would be created to fund such schemes—without compromising on capital spend—would be keenly watched.

As has been the trend for the last few years, ICRA expects the interim budget to increase the capital outlay towards infrastructure sector significantly. A major part of this capital outlay is expected to be budgeted towards roads and railways. Dedicated allocations for specified large infrastructure projects announced, such as Bharatmala and Sagarmala, are likely to be made to expedite these projects. While the pipeline of projects to be awarded in these sectors remains strong, an increase in budgeted capital outlay will enhance visibility of conversion of the projects planned. While the expenditure on national highway development has increased significantly over the last 3-4 years, a major part of it has been funded by Internal and Extra Budgetary Resources (IEBR). An increased budgetary allocation will lower the dependence on IEBR and can support faster pace of highway development.

Apart from the core railways, and roads, the special focus of this budget is expected on the development of rural infrastructure like rural roads and rural housing. To meet the government's target of Housing for All by 2022, the budget is expected to announce an increase in PMAY (Rural) outlay for supporting construction of houses in rural areas. Similarly, capital outlay under PMAY (Urban), which includes assistance for constructing homes in urban areas, is also expected to be increased.

To benefit the weaker sections of the society at large and in line with past trends, we expect the target for institutional credit for agricultural sector will be increased. Similarly, for increasing credit supply to micro, small and medium enterprises (MSMEs), the refinancing target by the Micro Units Development and Refinance Agency Bank is expected to increase. As regards capital requirements for banks, the government has recently upsized the recapitalisation package by ₹410 billion for PSBs to ₹1.06 trillion for FY19 (₹900 billion in FY18). While we expect capital requirements for PSBs to remain sizeable at over ₹500 billion during FY20 to support about 10% credit growth, the budgetary allocation is expected to be lower than requirement on the back of expectations that PSBs may be able to raise some capital from the markets as earnings profile shows signs of improvement.

Overall, the interim budget is likely to introduce limited tax changes. The ability to stick to fiscal deficit targets, or the extent of slippage, the realism of revenue and expenditure assumptions and the size of the planned market borrowings for FY20 would be the key areas of interest.