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Q IDEAS OF INNOVATION

Ram Nath Kovind, president of India

To improve the standard of education, the government is following a multi-dimensional approach. To secure the future of the country, it is imperative that children... get full opportunity to transform their flight of imagination into concrete reality

UPA subsidised non-poor, UBI will help Modi end this

Despite Aadhaar & DBT, bad scheme-design ensures half the subsidies go to non-poor; raise tax slabs to help middle class

FPRIME MINISTER Narendra Modi wants to present a pro-poor and a pro-farmer budget later today, he would do well to allocate as much as possible for a quasi Universal Basic Income (UBI) for the country's farmers and, if possible, to the urban poor. While economists and fiscal purists will cavil at the costs, the choice before finance minister Piyush Goyal is whether he wants to continue with the UPAera policies of subsidising the non-poor and the design flaws that ensured large-scale waste, supposedly in the name of the middle classes. In the 2016-17 Economic Survey, chief economic advisor Arvind Subramanian pointed out that, in the case of food subsidies, for instance, the bottom 40% of the population got just 28% of the total spending and, in the case of NREGA, this was higher but not much better at 37%.

While some part of this will no doubt be addressed by greater use of Aadhaar and Direct Benefits Transfer (DBT)—amazingly, just ₹20,170 crore of rations have been given using Aadhaar authentication so far this year—there is a much larger design flaw here, one that was aggravated by the UPA. Its National Food Security Act (NFSA), for instance, gave an 80-85% subsidy on purchase of wheat and rice to two-thirds of the country's population; no one can possibly argue that two-thirds of the country is either poor or near-poor. Norwas the amount high enough to really matter. Since the cost difference between ration- and free-market wheat and rice is around ₹20-25 per kg at most, this meant that each family got ₹100-125 per month as a subsidy; of course, when you multiply this by 80 crore persons, the amounts become really large. And then there is the inefficiency. Pay ₹25 per kg for each family's 5 kg/person/month, and you're talking of a cost of ₹120,000 crore instead of the ₹170,000 crore that is the budget target for the year. The difference is justified by the need for FCI to procure wheat and rice, but if this benefits just 5-10% of the farmers, is it justifiable?

And while Modi will want to help the middle classes, this is better done by raising the tax-exemption limit from the ₹2.5 lakh that it is today. In a country, whose per capita income is around ₹1.4 lakh, this means that families who earn less than the average are being taxed. If the government was to keep the relative exemption limit the same as in, say, 2012-13—at that time, the per capita income was ₹79,573—the minimum tax slab should have been ₹3.5 lakh in FY19 itself. If the government was to double the exemption limit, to ₹5 lakh, it would go down very well with the middle classes—according to PRICE's income-survey, this would take 50-60 million households outside the purview of the taxman—and it may not affect the exchequer as much. In FY17, for instance, while 65% of the income tax returns were filed by those who earned less than ₹5 lakh, they accounted for just 38% of the income declared; in terms of actual tax collections, it will be much lower since the tax rate is much lower. Indeed, just a few weeks ago, the GST Council doubled the revenue threshold for firms to file GST to ₹40 lakh a year for precisely the same reason, to keep millions of firms outside the purview of the taxman; millions of firms who, in any case, don't contribute as much to tax collections. Should Modi act on them, both UBI and raising the tax threshold are moves that will be politically popular and will also make economic sense.

Finally, justice at ICICI

Board acts quickly now, but guilty of pusillanimity earlier

IVEN HOW JUSTICE BN Srikrishna's report has found Chanda Kochhar of violating ICICI Bank's code of conduct, it would seem the lender's board was a little too hasty on giving her a clean chit. It needed to have waited for an independent enquiry to look into the issue before rushing to exonerate the former MD & CEO. So if Kochhar's career has ended on an inglorious note, the board hasn't exactly covered itself with glory.

At a broader level, this episode at ICICI Bank is evidence that the boards of even so-called 'professional' companies, or those that are not run by business families, aren't exactly top grade. Kochhar appears to have acquired tremendous clout, so much so that she held her ground and was most reluctant to go when the allegations relating to inadequate disclosures on her husband's dealings with the Videocon group surfaced. Indeed, the board should have insisted she step down immediately and called for an independent probe into the matter immediately. It was only after the ICICI Bank stock tanked and investors expressed their concern that the board showed some urgency. Apart from hurting investors, the board's pussyfooting and treating Kochharwith kid gloves has hurt its reputation.

However, after the submission of the Srikrishna report, the board has now said it would terminate her services and will also take back a significant chunk of her remuneration over the past ten years. So, while the CBI case against Kochhar and others is likely to take a decade or two before the final verdict—after being challenged in various courts—is delivered, the ICICI board's actions have ensured that Kochhar pays an immediate and heavy price for her actions.

Indeed, while some have criticised Union finance minister Arun Jaitley's comments on the CBI case, in the light of the Justice Srikrishna report on Kochhar, Jaitley was also making the same point about the need to hurry along the case; as he argued, by including Kochhar's predecessor and successor in the FIR, the CBI was making the case more open-ended. Indeed, once the sanctity of the loan process was questioned, there was also the danger of other banks like SBI getting dragged into the mess.

It is unfortunate that episodes like the one at ICICI Bank take place despite so much talk about corporate governance and reforming of corporate boardrooms. Indeed, the former chief executive of the National Stock Exchange, too, is being investigated for a breach of the rules. The Kotak Committee's recommendations of increasing the number of independent directors in a year, capping the directorships that an individual can hold and increasing the number of board meetings are aimed at functioning of boards. But unless independent directors step up to the plate, it is hard to see any significant improvement taking place.

CostlyDeal

The US-Taliban accord serves only the Trump regime and the Taliban and jeopardises the future of Afghanistan

HE IN-PRINCIPLE AGREEMENT to end the war in Afghanistan, struck between the US and Taliban, does not bode well for the Asian nation and peace and security in the region. Discussions between the US negotiator and the Taliban are advancing weeks after the Trump administration said it wanted to pull out troops from Afghanistan. The US invaded the country to oust the Taliban and al-Qaida in October 2001 in response to the September 11 terrorist attacks, and the CIA, as recently as Tuesday, warned that Afghanistan could once again become a terrorist haven. The Taliban's entrenched control over the country generates widespread fear and scepticism that any progress on security and protecting women and minorities in the country could be lost if the path is cleared for extremists to take control of the country again.

According to the US representative, Zalmay Khalilzad, the agreement is still a "draft" and the two sides have agreed only "in principle" on just two aspects of a potential settlement of the conflict. The US promises to set a timeline for the withdrawal of its troops over a period of 18 months after an accord is signed. The Taliban, in return, has apparently promised to dissociate itself from al-Qaeda and the Islamic State, and prevent any terror attacks against the US from Afghan soil. The Taliban, however, remain noncommittal on a ceasefire and direct talks with the democratically-elected Afghan government to settle post-conflict arrangements. The sidelining of the Afghan government represents a victory for the Taliban and the safety assured to the US and the withdrawal of US troops present a victory for Trump. The deal puts at risk the gains made over nearly two decades of de-radicalising Afghan life and society. What is worse is, despite the US's historical role in destabilising the region, it is willing to make the Afghan government and other stakeholders when it comes to peace in the region mere pawns. The Trump regime—which has time and again hinted at being willing to do anything to reduce its military expenditure overseas, even over-deployment for peacekeeping—is worsening a problem of America's creation.

FISCAL FORECAST

BUDGET DETAILS WILL INFLUENCE UPCOMING MONETARY POLICY ACTION AND WILL FOCUS ON RURAL INDIA AND CONTINUED SUPPORT FOR MSMEs

Budget preview—what could give?

NDIA'S CENTRAL GOVERN-**MENT** will present its budget for FY20 on February 1. Because this is an election year, the budget is likely to be replaced by a new one once the new government takes over after national elections. Yet, it holds significance, because it gives a sense of what the likely fiscal package could be if the current government remains in power, and it provides a template that any new government could potentially use. In order to get a better understanding, it is important to put the budget in context. This is a national election year, which has traditionally been associated with a looser fiscal stance. There are also legitimate concerns that growth is slowing, but it is slowing to a more sustainable pace and it is slowing because of 'yesterday's' problems, which are likely to reverse.

There are risks of slippage on the deficit target, arising from a shortfall in GST revenues, the oil excise duty cut, weak income tax revenues, weak spectrum sale proceeds and a high oil subsidy bill. And yet, there are some notable offsets that could still help the 3.3% number to be achieved. Even though GST slippage of ~₹450bn for the Central government is likely to happen, assuming trends similar to last year, a healthy cess collection (already 80% of budget estimates) and an option to dip into the GST cess fund should help offset half of this slippage. A tad higher interim dividend from RBI, given that RBI profits in the ongoing year are likely to be higher than last year, could also help offset some tax revenue slippage and likely cuts in the (non-subsidy, noninterest) current expenditure, especially as the 7th Pay Commission pressures are behind us, could help, too. Raising rural incomes and supporting

small businesses are likely to be the important themes for the budget for the next year. Rural incomes have been weak. Following a seemingly successful experiment in Telangana, three other states have announced a direct cash transfer scheme for rural India which is likely to cost ₹300 bn per year, besides 10 others announcing farm loan waiver schemes of ₹1.9 trn. Recent research shows that a direct cash transfer scheme is perhaps



more effective in terms of helping the intended beneficiaries. If the government were to enact a similar direct

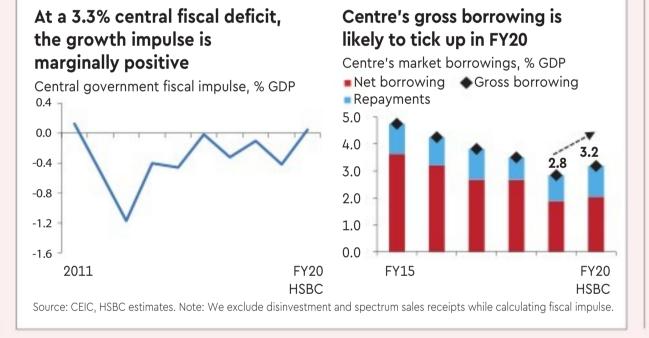
cash transfer scheme nationwide, it could cost around ₹2 trn (1% of GDP in FY20). However, if it were to subsume some pre-existing schemes, and is a shared burden with India's states, the additional burden would be lower. In recent months, the authorities have been announcing schemes to help India's

micro-, small- and medium-sized enterprises (MSMEs). This theme may continue into the budget, though spending more and running higher deficits to help small businesses can sometime prove counterproductive. Higher deficits could actually hurt the MSMEs as, if the government continues to dis-save, it is the smaller enterprises that will face higher borrowing costs and risk getting crowded out.

Any meaningful rural package is likely

India's Central government finances

% GDP	FY18	FY19 (BE)	FY19e (HSBC)	FY20e (HSBC)	
A. Total Receipts	9.2	9.7	9.4	9.6	
B. Total Expenditure	12.8	13.0	12.8	13.0	
Fiscal deficit	3.5	3.3	3.3	3.3	
Fiscal Financing (₹ billion)					
Net market loans	4,484	3,901	3,560	4,308	
% of GDP	2.7	2.1	1.9	2.0	
Repayments + Buybacks	1,396	2,154	1,670	2,400	
Gross market borrowing	5,880	6,055	5,350	6,708	
% of GDP	3.5	3.2	2.8	3.2	
Source: CEIC, Budget documents, HSBC estimates. RE= Revised Estimate, BE= Budget Estimate, Net market loans are adjusted for repayments and buybacks.					



to lead to funding problems. Instead of the pre-announced FY20 fiscal deficit target of 3.1%, it is estimated the Central government will announce a number closer to 3.3% of GDP, because, if it announces a new package for rural India, fiscal slippage to 3.3% is likely. Only a very slight increase in capex (0.1% of GDP) is expected, since it is a year when reviving rural incomes is the main objective. With the FY20 fiscal deficit at 3.3% of GDP, net borrowing by the Central government is likely to grow much faster than nominal GDP. Adding to this (1) the fact that RBI's

OMOs may not necessarily be as high as in FY19, and (2) the large repayments bill in FY20, and bondyields could potentially feel some pressure. Of course, any RBI rate cuts could relieve some of the pressure but let's pause to look at what is going on with inflation first.

Inflation in 2019 will display two distinct phases. Under 4% in the first half of the year since the period is likely to be characterised by growing demand for rate cuts given that inflation is under target and over 4% and rising in the second half given estimated rising economic growth and a low base for food inflation Given that inflation will be under 4% for about 12 months in a row (mid-2018 to mid-2019), it will be difficult to ignore the chorus for easing. However, those looking over a medium-term horizon may argue that inflation is likely to rise to 4% by the end of the fiscal year, and as such, rates should be kept on a prolonged pause. The deciding factor between these two

outcomes will probably be the FY20 budget. If the budget imparts a sense that the fiscal consolidation outlook is unclear, and rural incomes are likely to rise on the back of a credible rural package, RBI may choose to keep rates on hold. However, if the sense is that the fiscal path is broadly in control, and low rural incomes and food prices will linger for longer, space for a slight easing (of about 25-50 bps) could emerge. This is yet another reason why this budget is important, despite being an "interim" one.

Co-authored by **Aayushi Chaudhary**, economist at HSBC Securities and Capital Markets.

Edited excerpts from HSBC's *India* Budget Preview (January 28)

While continuance of the lottery

Budget must give IoT a push

Building an application ecosystem, preparing the network infrastructure and establishing strategic partnerships are essential to helping develop sustainable business models for 5G-enabled IoT services

RISHI BHATNAGAR & TV RAMACHANDRAN

Bhatnagar is president of Aeris Technologies India Pvt Ltd and Ramachandran is president of Broadband India Forum Views are personal

INDIA IS WITNESSING a phenomenal growth in internet of things (IoT). The adoption of IoT gained momentum when the Digital India mission was launched in 2015 followed by the 100 Smart Cities Mission in 2016. The Centre announced in the New National Digital Communications Policy 2018 that, as part of its Propel India vision to have a \$1 trillion digital economy by 2022, India would take a number of steps, including reaching an estimated 5 billion IoT connections by that timeframe. But much needs to be done to meet the ambitious targets set for 2022; the Union Budget offers a golden opportunity to effect this.

IoT transforms connected objects into "intelligent" products that have the ability to interact with their environment, other products/objects, people and applications. Specific use-cases or applications of IoT include smart cities, connected vehicles, smart grids, smart metres, smart homes, connected health, etc. The inherent complexity in connecting various devices, products, sensors, proprietary solutions, and platforms, etc, requires an ecosystem of device OEMs, technologists, connectivity providers, network and data scientists, platform and solution providers, system integrators, app developers and vertical and domain experts, along with security specialists. Government plays a crucial role in this ecosystem development by creating a favourable policy and regulatory environment, giving equal opportunity to both big and small players.

While government incentivisation with Make-in-India and Digital India has empowered the technology sector, a lot more needs to be done in terms of recognising and incentivising the efforts of the other parts of the digital ecosystem. Specialised IoTR&D centres will help develop new innovative sensors, devices, long-lasting and weather resistant batteries that

are tailored to Indian requirements. Likewise, IoT start-ups and solution-providers producing solutions specifically for the Indian market need to be recognised and given adequate attention so that they can scale and grow big enough and self-sustainable. A focus on skills development for IoT, AI, machine learning, blockchain and other emerging technologies can bring us to the forefront of the fourth industrial revolution.

The National Digital Communication Policy (NDCP) 2018 has recognised the need to rationalise levies in the telecom sector including licence fees, Spectrum Usage Charges, etc. This, once implemented, will go a long way towards providing the necessary incentive to the existing operators as well as the new breed of service providers. As demand for 4G and 5G increases with greater adoption of IoT, networks will become denser and deeper, making the fibre-isation of telecom towers imperative. The same has been recognised in the NDCP through several initiatives such as the Fibre First initiative, creation of a National Fibre Authority and the vision to connect 60% of all towers with fibre and 50% of households. Fibre to home would account for a majority of the fixed broadband connections by 2022.

5G-IoT is considered as the frontier that can improve our lives in many aspects and is set to transform our world completely. It is still at a nascent stage in India, but is increasing in importance for the government, corporate and regulators. The government has declared its intent regarding promotion of 5G-IoT through the NDCP, 2018. For IoT services to be deployed at scale, efficiently, 5G infrastructure is considered absolutely essential. These include improved network speeds and capacity, reduced communication latency and flexible service delivery models. The long-term vision, includ-

ing massive Machine Type Communications and Ultra-reliable & Low Latency Communications, is quite exciting. Some of the key industrial verticals where 5G is likely to make a huge impact are in the areas of automotive, industrial and healthcare. For city planners, 5G's massive IoT capabilities will build on existing mobile IoT services but enable far more devices to be connected by area and offer cost and energy savings. 5G will continue to improve on low power capabilities and allow operation in both licenced and unlicenced spectrum.

The momentum towards achieving 5G-enabled IoT needs serious consideration on interoperability between IoT solutions. All major standardisation bodies have established working groups dedicated to this goal. Despite there being several models of standards development, such as the proprietary- and government-led models, collaborative standards development has held a superior position. Building an application ecosystem, preparing the network infrastructure and establishing strategic partnerships are essential to helping develop sustainable business models for 5G-enabled IoT services.

The government has already taken the right steps by initiating well thoughtout and forward-looking reforms through the new NDCP. It needs to now fast track the implementation of the policy, get all the stakeholders on board and take the country forward to unleash countless business opportunities, thereby leading the industry to its next level of transformation. Realising the great importance of 5G for Digital India, the Centre made a landmark announcement in the last Budget of a significant financial allocation for 5G. It needs to do the same for IoT incentivisation in India. Given the right support, India could well become a world leader in IoT.

LETTERS TO THE EDITOR

Trump card

system would even the chances of selection for applicants, it is more than likely that the new H1B norms would facilitate firms in the US to employ foreign workers with a US master's or higher degree. At a time when shortage of experienced professionals with desired level of niche skills has aggravated the issues of a lopsided work culture, uneven wage structure and high staff turnover, a restrictive immigration policy doesn't favour the international businesses. Although the move can bring about public cheer, boost the domestic job growth, encourage selective brain-drain and promote start-ups, it doesn't strive to attain equal employment prospects and runs a risk of widening the skill-gap in advanced technologies. It is indispensable to sustain a competitive market for the export of services and products and curb the rising insecurity among the workforce to promote the development and application of advanced intelligent systems — Girish Lalwani, Delhi

Fall from grace

ICICI Bank former CEO Chanda Kochhar's fall from grace is complete with an enquiry report submitted by Justice BN Srikrishna concluding that there was a lack of diligence with respect to annual disclosures and violation of code of conduct on her part. Kochhar also faces criminal charges brought by the CBI over loans to the Videocon Group, with which her husband had a business relationship. The damning indictment must sent out a stern message to captains of industry that it does not pay to misuse authority — Ravi Chander, Bengaluru

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Regd. No: DL-21048/03-05. R.N.I. No.26750/74. Printed and Published by R.C. Malhotra on behalf of The Indian Express (P) Limited and printed at The Indian Express (P) Limited Press, A-8, Sector-7, Noida - 201301 and published by R.C. Malhotra on behalf of The Indian Express (P) Limited at The Indian Express (P) Limited Press, A-8, Sector-7, Noida - 201301 and published at The Indian Express (P) Limited Press, A-8, Sector-7, Noida - 201301 and published by R.C. Malhotra on behalf of The Indian Express (P) Limited at The Indian Express (P) Limited at The Indian Express (P) Limited Press, A-8, Sector-7, Noida - 201301 and published by R.C. Malhotra on behalf of The Indian Express (P) Limited at The Indian Express

FINANCIAL EXPRESS

ARELY HAS THERE been as much anticipation of an Indian Budget as this year. This is surprising because, being an election year, the government simply presents a Vote on Account or an interim Budget seeking parliamentary approval for grants typically for just four months of the next fiscal year, before a full Budget is presented by a new government in July.

Interest, however, stems from the current macroeconomic backdrop. With states' deficits rising, GST collections under pressure, and India's total public sector borrow requirement at a hefty 8.2% of GDP in 2017-18, all eyes are on whether the Centre can keep to its budgeted consolidation for 2018-19 and, if so, whether the quality of consolidation will be compromised by having to cut capital expenditures. Further, perceived distress in both agriculture and SME sectors has increased pressure on authorities to announce some sort of "agrarian package" or a quasi-universal basic income potentially involving cash transfers, as well as palliatives for the SME sector. All this could put pressure on next year's deficit. Against this backdrop, this piece raises five questions to help navigate India's Budget and what one should monitor on February 1.

1. Will the government meet its 2018-19 fiscal deficit target and, if so, how? We expect authorities will do what it takes to either meet the budgeted central deficit target of 3.3% of GDP or come close to it. Having overshot (albeit modestly) last year's deficit target, and with bond and currency markets exhibiting nervousness, we believe policymakers will want to reassure markets on the sanctity placed on fiscal targets.

The fiscal challenge this year is real. We had worried on Budget day itself last year that GST revenues had been budgeted too ambitiously and, unfortunately, this has come to pass, compounded by repeated tax cuts by the GST Council in 2018-19 and patchy GST compliance. Aggregate GST revenues have only grown by 6.6% over year ago between August and December, much below nominal GDP growth. We expect gross GST collections to be short by about 0.8% of GDP. However, because 42% of the divisible pool goes to the states, the net impact on the Centre will be close to 0.5% of GDP. We also think the asset sales (disinvestment and telecom spectrum) target of 0.6% of GDP will be challenging to achieve given the current run-rate. All told, we expect revenues to be about 0.5% of GDP lower than budgeted, and this presumes an interim dividend from RBI to the tune of 0.2% of GDP.

However, we expect adjustments will be made on the expenditure side. Because expenditure was slashed in the last few months of the last fiscal, the budgeted expenditure growth was not as austere as initially believed. Instead, de facto budgeted expenditure growth is a healthy 14%, and expenditures are running much below that target. In other words, there will be expenditure savings to offset revenue challenges. That said, capital expenditure growth is running at only 4%, and the worry is budgeted capex will be a casualty of this year's deficit.

The good news is we expect policymakers will stick to the 3.3% of GDP target or come very close, and that this will calm markets. But there are two challenges: (1) GST revenues remain anaemic; and the (2) quality of the fiscal consolidation will be imperilled by capex having to bear the brunt.

2. Will the 2019-20 Budget continue with consolidation?

We believe the 2019-20 Budget will continue with modest fiscal consolidation, targeting a deficit of 3.1% of GDP (or very close to that) in line with the FRBM Review Committee's recommendations. To be sure, the assumptions of the interim Budget are less binding because they will be revisited when a full Budget is presented. Yet it would be important to analyse what tax buoyancy has been budgeted for 2019-20. With GST revenues

sharply undershooting, tax buoyancy is





Emerging Markets Asia, Economic and Policy Research. Views are personal



Five questions on the Budget

Perceived distress in both agriculture and SME sectors has increased pressure on authorities to announce some sort of

'agrarian package' or a quasi-universal basic income potentially involving cash transfers, and palliatives for SMEs



Central government fiscal balance (% of GDP)

	FY18A	FY19B	FY19RE (JPM Est)
Revenue receipts	8.6	9.1	8.7
Tax revenues (net)	7.4	7.8	7.3
Gross	11.4	12.0	11.2
Direct tax	5.8	6.1	6.1
Indirect tax	5.6	5.9	5.1
GST	2.6	3.9	3.1
Less: States	4.0	4.2	3.9
Non-tax revenues	1.1	1.3	1.4
Non-debt capital receipts	0.7	0.5	0.4
Disinvestment	0.6	0.4	0.3
Total receipts	9.3	9.6	9.1
Revenue expenditure	11.2	11.3	11.0
Interest payments	3.2	3.0	3.0
Capex	1.6	1.6	1.4
Total expenditure	12.8	12.9	12.4
Fiscal deficit	-3.5	-3.3	-3.3
Fiscal deficit ex	-4.1	-3.9	-3.7

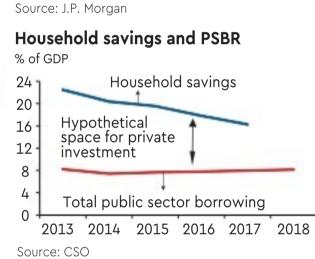
Source: CGA, J.P. Morgan estimates

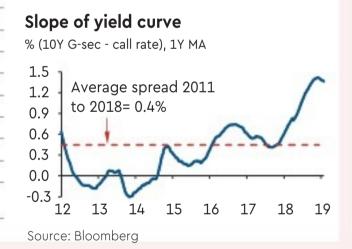
expected to be just 0.9 in 2018-19 compared to 1.2 in 2017-18. We expect measures to improve GST compliance after the election. Notwithstanding that, we think a buoyancy much above 1.1-1.2

would be challenging to accomplish. On the expenditure side, the key is whether any new "agricultural package" is announced and how it will be financed. Will it partially replace existing welfare programmes, or will new measures of revenue be sought or does it risk creating a new, unfunded liability? Finally, the fiscal wild-card for 2019-20 is whether the government will be recipient of any "excess capital" from RBI's balance sheet and whether this is used to retire public

Public sector borrowing requirements (PSBR) % of GDP Total public sector borrowing Consolidated 1.0 fiscal deficit 0.5 Public-sector enterprises + off- balance sheet (RHS)

FY13 FY14 FY15 FY16 FY17 FY18





debt, recapitalise public sector banks or finance new spending on the budget.

3. How should one evaluate the announcement of an agricultural pack-

age and/or cash transfers? Markets are ripe with expectancy that authorities are on the cusp of announcing an "agricultural package" potentially involving cash transfers to constitute a basic income for the rural economy. Any such package would need to be assessed

on five dimensions: ■ Who is it targeting? Will this be directed just towards farmers? Or the rural economy more broadly? Or even the urban poor? The more targeted it is, the

more fiscally viable it will be. Equally, however, the greater the targeting, the greater the chance of exclusion errors (intended recipients being left out) or inclusion errors (unintended recipients being included). Hence the temptation to quasi-universalise. But that must be traded-off against fiscal viability.

■ What is the quantum of the cash transfer? If directed to farmers, this will likely be a biannual payout like Rythu Bandhu scheme in Telangana. If this is meant to be a basic income for the rural economy, there will be a monthly pay out. What will that quantum be and how will it be indexed? ■ Will any cash transfer be uncondi-

tional or contingent (on land holdings, for example)? Any payout on land holdings (per hectare, for example) will be regressive (disproportionately benefiting rich farmers with larger holdings). It may also distort the decision of a small farmer to sell the land and move out of agriculture to higher value-added manufacturing/ services, which must be the goal.

■ How quickly can it be rolled out? Financial inclusion has improved. But is last-mile connectivity in place? Do the most needy and marginalised have operational bank accounts to receive and access such a transfer? How long will it take to ensure the financial infrastructure is actually working?

■ How will this be funded? This will be the key question that markets will likely focus on. Will an agricultural package replace or subsume exiting programmes? Will new sources of revenue be sought?

4. What net and gross borrowing can markets expect?

Under our assumption of a fiscal deficit of 3.1% of GDP, we expect net market borrowing to amount to ₹4.2-4.4 trillion. This assumes the proportion of the deficit that is financed by market borrowing remains (at a relatively low) 66%. There are also large redemptions next year to the tune of ₹2.4 trillion. However, we expect the government will undertake "switches" of about ₹400 billion before the end of this fiscal, such that redemptions for 2019-20 are brought down to ₹2 trillion. We expect gross borrowing to be in the range of ₹6.2-6.4 trillion—or about 3% of GDP.

5. (Don't miss the forest for the trees) What is India's public sector borrowing requirement (PSBR)?

Even as markets continue to obsess about the Centre's fiscal stance, we have maintained that is to miss the forest for the trees. The fiscal centre of gravity has moved to states, whose combined expenditure is much higher than the Centre and whose combined fiscal deficit has increased over the years, offsetting the Centre's consolidation. If one were to add off-balance-sheet borrowing (by FCI, for example) and borrowing by CPSEs, the total PSBR for India remained a hefty 8.2% of GDP—a level at which it has been close to for five years. Note this estimate is a "floor" because it does not include borrowing by state PSEs, including state electricity distribution companies.

A lot of the borrowing—particularly by states and CPSEs—is to finance muchneeded capex. But a PSBR of this quantum—sustained for several years—constitutes a large claim on domestic household financial savings, which have fallen in recent years from 22% of GDP to 16%, and likely explains why the slope of India's yield curve has steepened.

A PSBR of such quantum is perhaps rationalisable at a time when private investment has been depressed. But if private investment were to pick up—as is hoped—it would need to be accommodated by the public sector reining itself in. Else, borrowing costs would rise sharply—and crowd out some private activity—or India's CAD would swell, and private investment would need to be financed by (more risky) foreign borrowing, at a time when global interest rates are hardening, and uncertainty and volatility remain elevated.

> (Excerpted from JP Morgan Asia Pacific Emerging Markets Research dated January 30, 2019)

• INTERIM BUDGET 2019

Making aluminium shine

ANSUMAN DAS

The author is former CMD, NALCO, and an aluminium sector expert

The government should consider protecting the aluminium sector if it wants to keep India's growth story intact

F ONE LOOKS at the global trend, aluminium is

becoming a crucial piece of metal for a number of

economies; the metal is increasingly playing an important role in the process of nation building. For India, too, the trend applies. The major sectors identified as key to the country's Make-in-India initiative consume aluminium. In addition, aluminium is becoming a sector of strategic significance considering the role it plays in energy security, aerospace, defence, infrastructure and automobiles, and its adoption for government initiatives like Smart Cities, Power for All, and indigenous space programmes. The key role the aluminium sector plays is reflected in the

rapid pace at which the domestic aluminium producers have been making investments—amounting to ₹1.2 lakh crore over a few years, and increasing the capacity to 41 lakh tonnes per annum. This can easily cater to India's requirement of 36 lakh tonnes per annum (as of FY18).

Yet the country continues to meet 60% of demand through imports, even as domestic market share declines to 40% in FY19. Moreover, FY18 witnessed highest imports of ₹19.6 lakh tonnes, resulting in a foreign exchange spend of ₹30,000 crore—or roughly 1% of India's total imports. It is expected that, in current conditions, the import of aluminium will result in an estimated foreign exchange outflow amounting to a hefty ₹40,000 crore in FY19. Also, the import of scrap aluminium has posed serious threats—with 57% share of the total imports. In fact, it is the duty differential between primary and scrap aluminium that is seemingly encouraging the use of the latter. This differential is a misfit in the metals industry, where other non-ferrous metals see a duty parity.

In the Budget, the government should contemplate increasing the customs duties on both primary aluminium and the scrap metal to 10%

The current global geopolitical dynamics, too, are having a major effect on India's aluminium sector. For instance, the trade war between the US and China that led to a hike in import tariff on aluminium on both sides, and China's decision to add aluminium scrap in the restricted import list, are expected to divert the global scrap supply chain towards India due to its subpar standards for scrap import. The

domestic Indian industry is witnessing 22% growth in the period of April-November FY19 over the same period last year. In contrast, domestic sales saw the growth declining to 0.8%. Scrap import from the US grew by 142%, while the total scrap shipment increased by 20% in the same period.

India is far from protecting the interest of its domestic industry. Without actively doing so, India will not be able to create self-sufficiency in aluminium—its import dependency will deplete its treasury. Restricting aluminium imports will result in saving \$5 billion of foreign exchange outgo. If the government wants to curb imports, save foreign exchange, and encourage domestic consumption to boost economic growth, as part of the upcoming Union Budget or as an interim measure it should seriously contemplate increasing the existing customs duties on both primary aluminium and the scrap metal to 10%, and thereby establish an import duty parity between the two—which is similar to other non-ferrous metals.

Further support should also be extended through adequate safeguard measures, similar to those adopted for the Indian steel industry over the last three years.



INTERIM BUDGET

S THE GOVERNMENT presents its last annual Budget before the next general elections, there are a few areas we hope the finance minister to consider. Foremost among them is a longdue tax reform by restoring benefit under section 88E of the Income-tax Act. This was introduced in 2004 as a set-off benefit on the tax paid on business income, equivalent to the Securities Transaction Tax (STT) paid. This set-off, which helped mitigate the negative impact of STT, was withdrawn three years later and is now available only as a rebate on business income. Restoration of benefits of section 88E is necessary to avoid double taxation as business income is already taxed at the transaction level.

India's commodity market is undergoing reforms; these need to be strengthened. For instance, institutional participation in this market. After Budget 2017 provided for broad-basing participation in India's commodity derivatives market, SEBI has been taking steps to allow its regulated financial institutions to participate. Likewise, other institutions—pension funds, insurance companies and, importantly, banks—also need to be allowed. Their presence is important for sustaining their long-term healthy growth while adding value to the market with their research-backed investment strategies.

A wish list for commodities

India's commodity market is undergoing reforms; these now need to be strengthened

MRUGANK PARANJAPE

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Besides, to promote hedging of commodity price risks among multiple stakeholder groups, the government can encourage hedging by statal/parastatal bodies such as agriculture marketing boards, commodity boards, etc, which are exposed to commodity price volatility. Hedging will not only de-risk their own finances, but also provide demonstration effect to many others to manage risks through hedging.

The government has been taking steps to address farmers' distress. A useful (and proven) tool to link farmers to assured output and input markets is by promoting farmer producer organisations (FPOs). Farmers have been able to lock-in prices

and sell output on commodity derivatives platform too, through FPOs, but in a limited manner due to their low capital base. The government can provide capital support to FPOs, which they can leverage for raising finance, getting better terms in purchase of inputs or sale of output, etc. FPOs can provide a host of services to farmers across the value chain, enabling them access markets for inputs, output, finance or risk management. The farming community can also be supported by providing timely and reliable information about prices—current and future. State support, using public resources, for timely dissemination of prices will help farmers



make use of such information in sowing and marketing decisions.

In the previous Budget, the government had announced it would come up with a comprehensive 'gold policy' to develop gold as an asset class. The policy announcement on this is awaited. Financialisation of the estimated 20,000 tonnes of gold held by Indian households would help finance economic activities, essentially converting a non-productive wealth into a productive asset. Gold mar-

ket stakeholders are also keenly awaiting detailed guidelines and regulatory architecture for an electronic 'gold spot exchange'. As in countries like Turkey and China, a gold spot exchange can help mobilise and recycle existing stock of gold in the country, provide a transparent medium for transactions, promote standardisation in the metal, ultimately leading to emergence of a globally-acceptable 'India Standard' for gold.

Continuing reforms in the energy sec-

We wish for a 'gold policy', and complete deregulation of prices of all hydrocarbon products eventually, so that the real strength of the Indian energy market can be realised

tor would be welcome. Progressive deregulation has led to freeing of prices of petrol and diesel. This has been an important step in making the energy market market-determined, paving the way for introduction of financial (including hedging) products on these commodities, releasing fiscal resources and incentivising innovation in the energy market. The trend needs to continue and we wish for complete deregulation of prices of all hydrocarbon products eventually, so that the real strength of the Indian energy market—one of the largest in the world is realised. Reflection of real economic value in energy prices will encourage efficiency in use by consumers and spurt R&D in production by producers.

Policy changes, backed by appropriate actions, in the above-mentioned areas can bring in transformational changes in the specific sectors they pertain to, and the Indian economy in general.