The revenue challenge

The new government must focus on its revenue streams as it prepares for its first Budget

RAISINA HILL

A K BHATTACHARYA

How much of the expenditure compression during 2018-19 has been achieved by deferring expenditure to the following year? Or how much of it was the result of off-Budget borrowing by public sector entities?

The Union government had cut its total expenditure by about ₹1.45 trillion over its revised estimates for 2018-19. Of this, ₹13,000 crore was cut on account of capital expenditure and ₹1.32 trillion under revenue expenditure.

As has already been reported (*see: https://mybs.in/2X6k171?*), the bulk of the expenditure compression was achieved through off-Budget borrowing. The burden of such borrowing has fallen on many public sector undertakings (PSU) such as Food Corporation of India (FCI), Housing and Urban Development Corporation, National Housing Bank and Rural Electrification Corporation.

Even though there is no official confirmation of such borrowing, the figures put out by the Controller General of Accounts (CGA) have revealed it all. For instance, the CGA's 2018-19 figures show how the food subsidy bill came down by a whopping 40 per cent over ₹1.71 trillion mentioned in the revised estimates.

The decline in the food subsidies bill accounts for over half of the total revenue expenditure compression. That the entire burden has been shifted to the FCI can be gauged from the fact that the April 2019 numbers reveal no impact of any deferred expenditure.

In April 2019, the government released ₹46,862 crore of food subsidy, compared to ₹48,430 crore in the same month of 2018. Even as a percentage of the Budget estimates for the two years, the government's food expenditure bill was lower at 25 per cent in 2019 compared to 29 per cent in 2018. Clearly, there is no impact of deferred expenditure here. Instead the figures indicate a small compression.

In other words, the government may have managed to completely free itself of any deferred expenditure on account of food subsidy in the current financial year. The borrowing burden is now on the FCI. What this means for FCI's financial health is of course a different matter and a deeply worrying phenomenon for India's public finance.

In contrast, the government's subsidy expenditure on account of fertilisers and petroleum products shot up hugely in April 2019. Compared to a subsidy spend of ₹2,582 crore for petroleum and ₹7,124 crore for fertilisers in April 2018, this year the same expenditure has more than doubled to ₹5,281 crore and ₹16,943 crore, respectively. This is puzzling. In the final CGA figures for petroleum and fertiliser subsidies during 2018-19, there was no major reduction, compared to the revised estimates. Yet, the April 2019 expenditure shows a significant jump.

It is, however, clear that the government's major subsidies bill on account of food, petroleum and fertilisers will not be a cause for concern during 2019-20. Without the burden of any deferred expenditure, meeting the major subsidies bill of ₹2.96 trillion should not be a problem, as long as international crude oil prices remain within a range of $65-70 a barrel.

The CGA figures for April 2019 also outline the revenue challenges before the finance ministry. The ministry team, currently busy preparing the full Budget for 2019-20, must have noted that the net tax revenue in April 2019 was estimated at ₹71,637 crore, which represents a 24.5 per cent increase over the net tax revenue of ₹57,533 crore in the same month of 2018.

This level of revenue growth would have been a cause for celebration in the normal course. But, thanks to the sharp drop in actual revenue collections compared to the revised estimates, this underlines the huge revenue challenge that lies ahead. The net tax revenue growth target for the current financial year is now as high as 29.5 per cent. Can the net tax revenue growth be raised further during the course of the year? Or should the Budget makers recognise the challenge and try to make the targets look more realistic?

Non-debt capital receipt is the only item on the revenue side that provides some comfort. The government booked a revenue of ₹2,350 crore of revenue from disinvestment in April 2019. Of this, ₹476 crore was mobilised by selling 12 per cent stake in Rail Vikas Nigam Limited through an initial public offering and ₹1,874 crore was raised by sale of enemy property. This was substantially higher than ₹435 crore of such receipts recorded in April 2018.

Even though the government may have been in election mode in April 2019, it seems both tax revenues and disinvestments did well, bringing down the overall fiscal deficit as per cent of the Budget estimates compared to the same month of 2018-19. Perhaps, more attention needs to be paid to these two areas as the new government readies to present its first Budget on July 5.

For Reserve Bank of India, small is beautiful

The small finance banks should be rechristened national development banks as their mandate is financial inclusion

BANKER'S TRUST

TAMAL BANDYOPADHYAY

The Reserve Bank of India (RBI) will soon open its window accepting applications for small finance banks' (SFBs) licence through the year. The draft guidelines for such "on-tap" licensing is likely to be ready by August. The decision is important in many ways.

First, it encourages the non-banking finance companies (NBFCs), including microfinance institutions (MFIs), to become banks. This will take care of liquidity problem (in the long run), governance and financial inclusion. Second, it charts out the glide path: Every entity that wants to become a universal bank will have to take this route of transformation. It also means that the on-tap licensing window for universal bank is shut, for the time being. Finally, it demonstrates the Indian central bank's confidence in the new set of banks, many of which are completing their second year of existence.

The RBI had given in-principle approval to 10 entities for entering the small finance banking space in September 2015. Eight of them are MFIs, one an NBFC and another, a local area bank. Along with the SFBs, the RBI also gave licences to 11 payments banks.

If nothing else, the numbers — 72 applications for SFBs and 41 for payments banks — illustrate how starved of banking services is Asia's third largest economy.

The SFBs are subject to all prudential norms like any other commercial bank and, on top of that, they need to give 75 per cent of their loans to the so-called priority sector (for universal banks it is 40 per cent); up to ₹10 lakh of such loans do not need to be backed by any collateral security. And, 50 per cent of an SFB loan portfolio should constitute smaller loans of not more than ₹25 lakh. An RBI review of the performance of the SFBs reveals they have achieved their priority sector targets and the mandate for financial inclusion.

Payments bank is a different story. It is not allowed to give any loans; it can take deposits (maximum ₹1 lakh) and 75 per cent of such deposits will have to be invested in government securities while the rest can be placed as deposits with other commercial banks. Quite a few entities have surrendered their licences as they found it difficult to discover the right business model.

Three small finance banks are listed on bourses; their financials are in the public domain. The performance of the rest varies between good and indifferent.

What are their challenges? Indeed, technology is a challenge but a bigger challenge is human resources — getting the right talent on board as many such banks are headquartered in small cities and they can't pay the top dollar. A far bigger challenge is compliance with RBI's regulatory norms. Migration from a light-touch regulation to a highly regulated arena is not easy. In private, hand on heart, many promoters of such banks say the cost of regulation is too high and, given a choice, they would have loved to go back to the MFI days. Many of them are still grappling with the task of deposit mobilisation. Most senior citizens are rate-shoppers but higher interest rate may not be the hook to attract others who look for many financial products under one roof.

Despite all these, the SFBs are a remarkable story in a credit-starved nation. While the payments bank model is yet to pass the test of time, the SFBs will create a more diverse banking sector. Going by the December 2018 data of MicroFinance Institutions Network, a self-regulatory body, SFBs' share in the microfinance pie is little over 18 per cent (₹30,187 crore) in contrast to MFIs' 36 per cent (₹60,631 crore), banks' 36.5 per cent (₹53,605 crore) and NBFCs' 10.7 per cent (₹17,852 crore). Others account for 2.4 per cent of the small loan market (₹4,010 crore).

Since the RBI wants to take a relook at the licensing norms before opening the licensing window, here are a few unsolicited suggestions:

- The dividing line between the SFBs and MFIs are quite vague. In fact, many SFBs are primarily banking on the MFI business model even after becoming a bank. As a result, there is scope for regulatory arbitrage and confusion.

For instance, a small borrower cannot take money from more than two MFIs but this restriction is not applicable to SFBs or universal banks. There are banks liberal in giving loans to the small borrowers to prevent them from approaching SFBs and MFIs. Besides, the MFIs are not allowed to extend more than ₹1 lakh loan to any single borrower but the same borrower can take double the amount from SFBs and universal banks. This leads to over-leveraging and can spell trouble in future. This is important as 85 per cent of the MFI loans need to be given to group borrowers who do not need to offer any collateral.

- The capital requirement for SFBs must be raised from ₹100 crore. They need money to put in the right technology platform and creating the branch network.
- The SFBs could be allowed to continue with the bank borrowing for first three years of their existence as it takes time to build the deposit franchise. An abrupt transition is not healthy either for capital or liquidity.
- Now that the RBI is ready to welcome more SFBs, the regulator must create a separate division for their regulations. Its inspection team needs to be trained separately as SFBs are a different kettle of fish like, say NBFCs and regional rural banks. There should be a separate supervisory cadre for these banks.
- There are quite a few micro issues too. For instance, for securitisation of a micro loan by a bank, the interest rate is capped at 8 per cent over a bank's MCLR (marginal cost of fund based lending rate) but in reality such loans are priced much higher. Similarly, affordable housing loans can be given the same status as agriculture loans. This will encourage the SFBs to get into this segment in a big way and address the housing shortage. This also strengthens the SFB balance sheets as such loans are secured.
- Finally, the SFBs should be rechristened as National Development Bank. They are in the business of financial inclusion. More importantly, the "small finance bank" sobriquet creates confusion and negativity among the depositors. Most of them are scared to park their money with this genre of financial intermediaries as they are not a "bank" but a "small finance bank". The fact that they are licensed to do business by the RBI does not cut ice. This slows down the deposit mobilisation process. Unless they are able to raise cheap deposits, they cannot pare the cost of their loans. So, the very purpose of creating the new sets of banks gets defeated.

NEW STRATEGY **The RBI as a regulator must create a separate division to regulate SFBs. Its inspection team needs to be trained separately as SFBs are a different kettle of fish**

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CHINESE WHISPERS

Politics of business

The three-language proposal in the draft National Education Policy has become the focus of a heated political debate in Tamil Nadu, where it has quickly taken the shape of an anti-Hindi agitation by Dravidian parties. What is interesting is a tweet by Bharatiya Janata Party leader H Raja listing out the schools run by Dravida Munnetra Kazhagam (DMK) leaders in the state. Raja has alleged that DMK leaders, including president M K Stalin's daughter who runs a school, are up in arms because their business (of running schools) would be affected if the three-language formula were to be implemented. In Chennai city alone, DMK leaders and their family members run at least five schools, while across the state, close to a dozen schools are run by them, alleged the BJP leader.

Singur back on Mamata's table

The Trinamool Congress' recent loss in Singur, part of the Hooghly Lok Sabha seat in West Bengal, has hurt the party perhaps the most. In an internal meeting, Trinamool President and Chief Minister Mamata Banerjee *(pictured)* reportedly told her colleagues the defeat was "a shame" for the party, and that "it is our fault that we lost Singur". Understandable, because it was her agitation in Singur against the use of farmland to build factories that won her the CM's chair in 2011. The Left had sanctioned a Tata car factory there but the project was abandoned because of her agitation. The BJP's Locket Chatterjee won the seat. To regain lost ground, Banerjee will launch her Janasanjog Yatra or 'a connect with the people' campaign on July 21 as part of the Trinamool's annual Martyr's Day rally.

U-turn for B-team?

Before the Lok Sabha polls, the Congress had accused Maharashtra's Vanchit Bahujan Aghadi (VBA), led by Dalit leader Prakash Ambedkar, of being a B-team of the Bharatiya Janata Party (BJP); now it appears the Maharashtra state unit of the Congress is in talks with the VBA for a pre-poll tie-up for the upcoming assembly election. Ambedkar is a grandson of the architect of India's Constitution, B R Ambedkar, and his party is backed by Hyderabad politician Asaduddin Owaisi's All India Majlis-e-Ittehadul Muslimeen. The two fought the Lok Sabha elections together, notching up a sizeable portion of the votes, while failing to win even one of the 48 seats in the state. The Congress' desperation is understandable — there is a threat of a mass exodus, a la the Trinamool in West Bengal, with Maharashtra Congress President Ashok Chavan alleging that Chief Minister Devendra Fadnavis is calling the Congress' Assembly lawmakers and urging them to join the BJP.

INSIGHT

Building a specialised supervisory cadre at the central bank

AMOL AGRAWAL

During the RBI board meeting held in May 2019, the central bank announced creating a specialised supervisory and regulatory cadre. The board noted the growing complexities and interconnectedness of the financial sector and wished to strengthen the regulation and supervision of commercial banks, urban cooperative banks and non-banking financial companies (NBFCs). In the June 2019 monetary policy, RBI Governor Shaktikanta Das termed this as a "major decision".

This is welcome news but what is not clear is the additional roles this cadre will play. The RBI already has two separate departments for this purpose: Department of Banking Regulation (DBR) and Department of Banking Supervision (DBS). The DBR, as the name suggests, looks at the overall functions of banking regulation that include licensing, branch expansion, maintenance of statutory reserves, operations, amalgamation, reconstruction and liquidation of banking companies. The DBS, on the other hand, deals with onsite and off-site surveillance of banks. Likewise, there are separate departments for cooperatives supervision and regulation and another department for non-banking regulation.

The history of how the RBI has organised itself over time to deal with banking regulation is quite interesting. At the time of the inception of the RBI, banks were governed by the Indian Companies Act (1913), which did not define banking but had certain provisions that allowed a firm to be called a bank. Thus, the first task of the RBI was to provide a definition of a bank. Under the amendment in Indian Companies Act, a bank was defined as "a company which carries on as its principal business the accepting of deposits of money on current account or otherwise, subject to withdrawal by cheque, draft or order". The amendment also prescribed a minimum paid-up capital of ₹50,000 for banks and a cash-reserve ratio on the bank's deposits.

Despite these changes, the RBI top brass wished for a comprehensive banking regulation. The wishes became an urgency as the failure of Travancore and Quilon Bank (formed by the merger of Travancore National Bank and Quilon Bank) in 1938 exposed the inadequacy of the banking laws and governance. The RBI studied banking laws in several countries such as Canada, Australia, the US etc and proposed large-scale changes to the government. The proposals were delayed due to World War II and then India's Independence. Most of these proposals became part of Banking Regulation Act (1949) that specified only banking firms should use the word bank and gave the RBI powers to inspect banks at will.

Institutionally, the RBI had established Department of Banking Operations (DBO) in 1945 to deal with all banking problems and inspection. In 1950, it established Department of Banking Development (DBD) following suggestions of Rural Banking Committee. Both DBO and DBD were very powerful departments in the early part of the RBI's history. The two were merged in 1965 to become the all-powerful Department of Banking Operations and Development or DBOD as financial market participants would call mostly with fear. In 1966, the RBI established a separate Department of Non-Banking Companies for regulating the NBFC sector.

Post the reforms of 1991, there were two more changes. The Narasimham Committee on financial sector reforms suggested streamlining of regulation and supervision which had become over-regulated and over-administered. It proposed separating the supervision function from other functions of the RBI and establishing a quasi-autonomous Banking Supervisory Board under the aegis of the RBI. The board would supervise not just banks but also NBFCs and development financial institutions. The board would be chaired by the governor and have three members drawn from different fields and one representative from the government. Accordingly, then finance minister Manmohan Singh announced establishing a Board of Financial Supervision in his Budget speech of 1993-94. The RBI also established a new Department of Financial Supervision to aid the BFS. However, the composition of BFS was different with four members drawn from the central board of the RBI. Over time, the scope of BFS was enlarged to include cooperatives, RRBs and primary dealers.

In 2014, the RBI made a Committee on Organisational Restructuring of the Reserve Bank (Chair: Deepak Mohanty). Based on the Committees' suggestions, the name of DBOD was changed to DBR (name of Rural Planning and Credit Department (RPCD) was also changed to Financial Inclusion and Development Department (FIDD). The RBI also separated the regulation and supervision tasks and placed DBR and DBS separately under two deputy governors and executive directors.

It is also interesting to note that RBI is not the lone central bank here. Before the crisis, central banks mainly looked at monetary policy and banking supervision was either delegated to a separate agency or demoted to a lower role. After the crisis, this thinking has reversed significantly. The US Federal Reserve now has a vice-chairperson for supervision (currently Randal Quarles) and releases a separate report on supervision and regulation. The European Central Bank is building a single supervision board (SSB), whose purpose is to build a harmonious system of banking supervision across member economies. The vice-chair of SSB is from the ECB's executive board and ECB separately nominates four members to the board (currently all positions are vacant barring one). The Bank of England is behind Prudential Regulatory Authority (PRA), which regulates and supervises around 1,500 banks, building societies, credit unions, insurers and major investment firms. Of the four deputy governors, one is CEO of PRA (currently Sam Woods).

These are interesting times for central banks. They have for long obsessed with monetary policy and sidelined the more basic function of banking supervision. The blame for the ongoing banking crises lies not just with bankers but also with the supervisors. Critics might say we have had banking regulation for ages now and new regulations will hardly help. However, what we are talking about is supervision, which is different. Regulation is writing rules and supervision is enforcing them. In fact, most banking policy action is around regulation and less about supervision.

Having said that, in the RBI's case, banking supervision has always been part of its DNA. It would have been much better if the RBI's central board had highlighted where the existing departments fell short and then suggested a remedy. Critics have pointed to the RBI's lack of supervision in the ongoing NPA crisis and fraud cases. Hopefully, the central bank will clarify the role of this new cadre and how it is going to add value to the RBI and the Indian banking system.

LACK OF SUPERVISION **It would have been much better if the RBI's central board had highlighted where the existing departments fell short and then suggested a remedy**

The author is a faculty at Ahmedabad University and writes a blog, Mostly Economics

LETTERS

Rajnath's silence

For many who had witnessed Bharatiya Janata Party (BJP) veteran L K Advani being insulted many times in public by BJP leaders, the slighting of Defence Minister Rajnath Singh, first by removing him as home minister and then by omitting his name from the various cabinet committees would not have come as a surprise at all.

What is really baffling is Singh's marked silence over his unceremonious shift to defence and his meek protest against his missing name in various cabinet committees. At first instance itself, when his self respect was needled by stripping him of his home portfolio, should he not have put down his papers and called it quits?

Further, Finance Minister Nirmala Sitharaman, who is much junior to him, is present in almost all the cabinet sub-committees. Isn't that an insult to injury?

Shalini Gerald Chennai

A service to people

Andhra Pradesh Chief Minister Jagan Mohan Reddy's experiment of appointing five deputy chief ministers to be selected from the SC, ST, backward classes and other minority communities is going to set a precedent in Indian politics. Giving a fixed term of two-and-a-half years only to each of the ministers is also a refreshing idea that will keep the other MLAs on their toes in working for the people and not get complacent. Being complacent might make them lose their chance of getting a ministry in the second half. Let the chief ministers of other states too emulate Reddy's example for which he deserves kudos. Politics needs to be viewed as an opportunity to service people rather than a plum profession.

Brij B Goyal Ludhiana

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Business Standard
Volume XXIII Number 212
MUMBAI | MONDAY, 10 JUNE 2019

Over to banks now

New NPA resolution norms are finely balanced

The Reserve Bank of India (RBI) has adopted a carrot-and-stick approach to the resolution of stressed assets. The new norms released last Friday have empowered banks to hammer out a resolution but have also put in place enough safeguards against any intent to evergreen stressed accounts. Lenders will be subject to stringent action, including higher provisioning and monetary penalties. Resolution plans shall provide for payment not less than the liquidation value due to dissenting lenders, the RBI said in its latest framework.

The most substantive change in the new stressed asset resolution norms two months after the Supreme Court struck down Mint Road's February 12 circular is that banks now get a 30-day window to decide if an account is a non-performing asset (NPA) as distinct from the earlier one-day default norm, which was both harsh and impractical. The revised circular gives non-banking financial companies (NBFCs), small finance banks, Nabard, Exim Bank and Sidbi a place around the resolution table.

The idea is obviously to make sure that most cases should be settled within the new framework, with the Insolvency and Bankruptcy Code (IBC) being the last option. While lenders have to be proactive, the RBI will continue to direct banks to start insolvency proceedings for specific defaults. If anything, pressure has been increased on the banks, which have to mandatorily sign an inter-creditor agreement (ICA). The ICA will provide any decision agreed by lenders representing 75 per cent in terms of voting share or 60 per cent of them in terms of numbers. Banks will have to work double-quick around their internal bureaucracies to ink an ICA within a month of default.

Failure to see the resolution plan (RP) through will entail an additional 35 per cent in provisioning — 20 per cent if they can't make it work within 180 days and an additional 15 per cent if no resolution is found within a year. The price to be paid by way of additional provisioning will be of worry for state-run banks, which have been recently capitalised and also the ones which continue to be under the RBI's Prompt Corrective Action framework. But it is unlikely the more prudent banks will be unduly bothered on enhanced provisioning as they would have already done so for the entire exposure on their own.

While the central bank's norms will apply to defaulters of ₹2,000 crore immediately, the same for those between ₹1,500 crore and less than ₹2,000 crore will kick in only from January 1, 2020. Such a staggered approach has raised a few concerns among banks — visibility is poor as to how they are to proceed from here on in the cases of exposures of less than ₹2,000 crore. Smaller banks in particular are worried on this aspect.

The thinking behind the revised circular is that the recognition of default or accounting for deterioration in the quality of assets should be independent of the reasons for such default or deterioration. The best part of the new norms is that they retain the spirit of the February 12 circular and offer a mechanism that will enable resolutions through requisite majority. The onus now is on banks to speed up resolution as the earlier circular impacted loans worth ₹3.8 lakh crore across 70 large borrowers.

GSP fallout

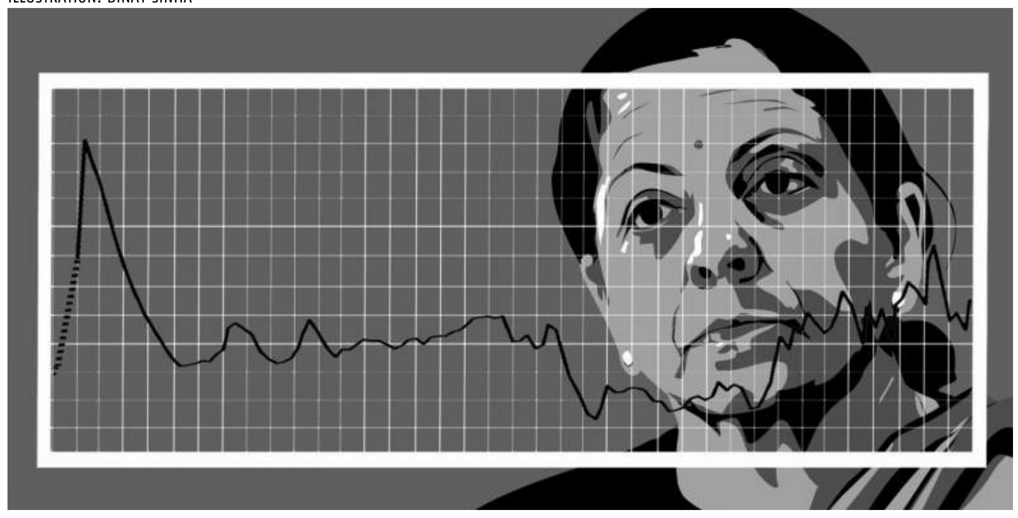
Govt must seek to restore competitive edge of exports

Trade relations between India and the US have continued to be an issue. The US administration has confirmed that India will be no longer be considered a developing nation for the purpose of benefiting from the Generalised System of Preferences (GSP). The GSP provides tariff-free access to the US market for companies from developing countries in certain sectors. But, the US has removed India from the GSP because it has not assured the US that it will provide reasonable and equitable access from America to its markets. This is an odd reason since the whole point of the GSP is not equity but special status to developing countries, which are deemed worthy of preferential access to US markets. The idea here is essentially that India has failed to convince the US government that it is in fact still a developing country, unlike, say, China. Some compromises, especially on poorly drafted domestic measures such as price caps for medical equipment and e-commerce policy, should have been attempted with the US. This is unquestionably a failure of both regular and economy diplomacy.

New Union Commerce Minister Piyush Goyal has said Indian exporters do not see the GSP withdrawal as a matter of "life and death". No one can quarrel with his comments that industry and exporters should not depend on government subsidies and instead focus on becoming more competitive. But the effects of this withdrawal of the GSP should not be minimised in any manner. Some senior government and other officials have been almost blasé about the effects, minimising the gains to India under the scheme as "only" $260 million a year. It is true that goods worth "only" $6 billion will be affected of the exports worth $54 billion from India to the US. But that is patently a wrong way of looking at the issue. There are specific sectors that will be hard hit because they operate on tight margins and the removal of tariff-free access to the US market will render them suddenly uncompetitive — they may be, on average, 7 per cent more expensive. Some of the sectors affected include imitation jewellery, leather articles other than footwear, pharmaceuticals and surgical instruments, chemicals, and plastics. Several of these sectors are dominated by small- and medium-sized companies that will have trouble staying competitive. A further fall in exports could not just keep growth from recovering, but also be another big negative for jobs.

The government will now have to work out how another negative shock to exports can be avoided. The first task must be to ensure that not too many exporters go under because of an inability to handle the transition. There must then be efforts to render the exporters in these sectors more competitive and cost-efficient by at least the 7 per cent margin that they have lost, thanks to the removal of tariff-free access. Direct subsidies or tax breaks should be used only as a last resort, such as has been created for the textiles sector under the Rebate of State and Central Levies and Taxes scheme. However, tax breaks cannot be a sustained solution either for textiles or for any other sector.

ILLUSTRATION: BINAY SINHA



A growth Budget

The Budget speech must include reform measures for PSU banks, a commitment to boost PSU bank lending, and specific measures to resolve the problems faced by NBFCs

NITIN DESAI

In less than a month from now the new Finance Minister, Nirmala Sitharaman, will present the first Budget of the re-elected government. Her challenge is to combine a sense of continuity with a promise of change to meet the high expectations aroused by the election campaign. But at the present stage this should be subordinated to the need to give an appropriate tonic to an economy that is showing signs of illness.

The litany of economic woes that she has to take into account is long and includes:

- A steady decline in the growth rate of GDP, which has come down to 5.8 per cent in the Jan-Mar quarter of 2018-19;
- Fiscal pressures because of a large shortfall in tax collections, leading to a real deficit of over 4 per cent of GDP in 2018-19, disguised by transferring an unprecedented volume of expenditure to this, the following financial year;
- Major problems in non-banking financial companies, with risks of default and serious fraud charges, which will put off investors and dry up flows to borrowers;
- Continuing balance sheet problems in the corporate sector with a quarter of large companies preoccupied with deleveraging and survival;
- Small- and medium-enterprises facing difficult credit conditions;
- Continuing concerns about the slow pace of job creation and farmer distress;
- A global economy threatened by the confrontation between the USA and Iran, the USA and China, and the slowdown in the prime drivers of global growth.

However, the first Budget of a new finance minister and a newly elected government cannot be just a repair job. Words and tone matter and the FM must fully use the communication skills she demonstrated when she was a party spokesperson. But what is the message she should seek to convey at the present juncture?

The finance minister's speech could project the Budget as the delivery of promises about infrastructure and welfare spending that figured in the ruling party's election manifesto. This option is not available this year as the recent data on tax collection trends do not leave much room for any big increase in public spending.

She could fulfil a similar political purpose by spelling out details of some of the major reform measures that are part of the manifesto. But that will be difficult as these details require more time to work out than the thirty days available to her before she presents the Budget.

A more standard option would be to focus on fiscal rectitude and the commitment to stay within the short- and medium-term deficit targets. But that may not be plausible, given the fact that the real deficit is running way above the target set in 2018-19 Budget and the Interim Budget tax projections look unrealistic.

The economy does face inflation risks because of the possibility of an oil price increase and the impact of a delayed monsoon on food prices. But these are supply-side pressures, which should not be met by demand-side containment measures like high interest rates or tight deficit control. Hence the recent reduction in interest rates is welcome and will certainly help. But the interest rate cut by itself is not enough. The rate cut must be passed on and the logjam in the capital market needs to be cleared.

The theme of this year's Budget speech should be what the economy badly needs today — a growth booster. Judging by company reports, growth in rural demand for fast-moving consumer goods has slowed. Reported sales figures for automobiles and other durables also suggest a slowdown perhaps because the boost which came from the Seventh Pay Commission bonanza is petering out. The problems of the NBFCs that provided loans for this purpose and for housing may also be a part of the reason. Growth in private corporate investment has been slowing because of the slackening of demand growth and because nearly a quarter of the large corporates are too focused on deleveraging and survival to consider fresh investment. Export growth has also been disappointing. What has kept the overall growth rate going is public spending.

What can the FM do to boost growth and investor sentiment?

She cannot consider a direct fiscal stimulus, given recent trends in tax collections. However, the Budget can help by policy changes that improve the demand prospects for industry. It could aim at bringing new consumers into the aspirational middle class fold perhaps by proposing calibrated indirect tax changes to the GST Council. It should include measures to strengthen the links between defence acquisitions and public procurement for high-tech infrastructure (e.g. metro rail) and domestic manufacturers by bringing them in at the design stage. Another area crying out for major reforms is agricultural marketing and processing. Would she be willing to announce measures that would rescue the dairy, meat-exporting, and leather industries from the challenge they face from *gau rakshaks*? The FM should put together a package of micro-economic measures in a growth-booster package for organised manufacturing and the informal sector, focusing on promoting demand growth and credit flow.

Given the turmoil and confusion in the financial markets, the FM as the controller of institutions that account for 70 per cent of all financial assets will have to deal at length with what she proposes to do. The Budget speech must include reform measures for PSU banks, a commitment to boost PSU bank lending, and specific measures to resolve the problems faced by NBFCs. If Sebi has some bright ideas on promoting domestic private equity and venture funds and for boosting IPO options, particularly for start-ups, the FM must find a place for them in her Budget.

Reforms to sustain long-term growth and employment potential, improve social security and living conditions can come later after they are more fully worked out. Fiscal prudence should not be forgotten; but it should be the sub-text rather than the dominant theme and must rest on plausible projections of revenues and expenditure. This Budget should focus on short-term growth boosters and provide a tonic to strengthen confidence and investor sentiment.

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How not to waste the NBFC crisis

IRRATIONAL CHOICE

DEBASHIS BASU

Over the last nine months, a few non-banking financial companies (NBFCs) like Dewan Housing and Finance (DHFL), Infrastructure Leasing & Financial Services (IL&FS) and those of the Anil Ambani group are unravelling like a slow train wreck. This has caused enormous turbulence in the financial sector and in a small segment of the stock market. Additionally, banks and mutual funds are feeling the heat because they have lent to these troubled finance companies. How bad is the crisis and what are the lessons from it?

The first thing we know, unsurprisingly, is that public sector banks (PSBs) are at the forefront when it comes to lending to finance companies. They include State Bank of India, at one time the elite among the PSBs, and now the poster boy of bad lending.

Only a few bad apples

The second thing we know is that this crisis is not ravaging the entire NBFC sector as it did in the late 1980s and again in the mid-1990s. In those periods, dozens of leasing and finance companies, many of them small fly-by-night operations, went belly up. Over the years, the regulation of finance companies has vastly improved and most of them are led by a better quality of corporate managers. That is why only three NBFCs are affected by the current liquidity and solvency crisis. In all three cases, the debacle is an outcome of overambitious managements trying to boost capital, loan books and profits by hook or by crook.

Just look around and you will see dozens of NBFCs like Bajaj Finance, Cholamandalam Finance, Shriram Finance, HDB Financial Services (a retail finance company of HDFC Bank), PNB Housing, Canfin Homes, and LIC Housing (in housing finance) are totally unaffected. Last year they improved their profits and loan quality. Only a few finance companies which lent indiscriminately to the real estate, which siphoned off money and played the market-cap game, are down in the dumps. These, and IL&FS, which is a category by itself, need to be liquidated systematically. So the Reserve Bank of India (RBI) is right; it is not a shadow banking crisis but a problem limited to a few bad eggs.

I cannot emphasise this enough since I see knee-jerk and even alarming policy prescriptions coming from sensible people. Speaking to a television channel, Ajay Piramal, who runs a large finance company called Piramal Enterprises and also has stakes in two Shriram group companies, said the RBI could open "a special window of funds that can be lent to NBFCs. Or if it can take the first loss of, let's say, 10 per cent, and ask banks to lend more to NBFCs". He also suggested that the "RBI can also look at a special purpose vehicle which can lend funds to NBFCs on short-term paper ... besides, there is the ECB (external commercial borrowing) route. Today, housing finance companies can raise money as ECBs only for affordable housing companies. Can they (RBI) make it (available) for all real estate lending ..."

Unless Mr Piramal knows something that no one else does, ideas like asking the RBI to take the first 10 per cent loss for the shenanigans of crooked managements seem extreme. So far, the RBI has kept a distance and said that no special support is needed. What I would like to see Mr Piramal doing (of course without talking about it) is to push the bad actors out of the system while he selectively picks on their better assets to strengthen his own formidable finance operations. This is how the system will be cleaned up and strengthened, not by asking banks to lend more to bad companies.

And which banks would lend more? Well, good private banks have been cherry-picking good assets already. So, when we say banks should lend more, we are really talking of PSBs, when they have lost quadrillions of rupees through corrupt and incompetent lending in multiple boom-bust cycles over the past 40 years. This policy prescription, of socialising losses after all gains have been privatised by a few crooked promoters, is exactly the opposite of how the capitalist system is supposed to work. Even if we need a bailout, the first thing to do is to sack current promoters and replace them with professionals with a mandate to liquidate the entity at the best price, as the government did with IL&FS. But our PSBs were unable to remove even Naresh Goyal in time and allowed Jet Airways to sink. Hence, a sensible bailout of NBFCs is a pipedream.

The real lesson

The main lesson from this crisis is the role of mutual funds and credit rating agencies, which offered the highest rating to junk paper. Both are regulated by the Securities & Exchange Board of India (Sebi), which needs to pull them up. In the 2017 bull market, the fund industry couldn't cope with the torrent of inflows from people, enticed by the mutual funds' *sahi hai* campaign. The quality of investment declined. However, just as oceans return the garbage we throw in, the market has thrown back the trash that mutual funds sold to hapless investors during the boom. This will happen over and over again, unless Sebi forces rating agencies and mutual funds to have their skin in the game, by changing the basic structure of regulation. Let's not waste this crisis with band-aid bailouts but look for a surgical cure.

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1984 and its afterlife

BOOK REVIEW

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Shortly after the presidential inauguration of Donald Trump and his counsellor's invocation of "alternative facts," anxious readers, bracing themselves for the worst, propelled George Orwell's *1984* back to the top of the best-seller lists. Published in 1949, under the shadow of Hitler and Stalin, the novel projects a nightmare vision of a future in which truth has been eclipsed. Its inventive vocabulary of state power and deception — Big Brother, Hate Week, Newspeak, doublethink, the Thought Police — clearly resonated with the despair of present-day Americans. As does the very term "Orwellian," used increasingly to describe any number of troubling developments: from Trump's habitual lying to the toxic politicisation of the news media; from the expansion of campus speech codes to Silicon Valley's hijacking of our data and attention (the citizens of *1984* are monitored continuously by "telescreens").

Orwell's novel is the subject of Dorian Lynskey's wide-ranging and sharply written new study, *The Ministry of Truth*. Lynskey, a British journalist and music critic, believes that *1984* — one of the 20th century's most examined artefacts — is actually "more known about than truly known" and sets out to reground it in Orwell's personal and literary development. This is just as well, since Orwell, ever suspicious of armchair intellectualism, made a practice of writing directly from experience, to the point of plunging himself into many of the crises of his day.

In 1936, he joined a coalition of left-wing forces opposing Franco in Spain. Intending to fight fascism, Orwell discovered its diabolical twin, Soviet communism, and became, in Lynskey's words, acutely aware of how "political expediency corrupts moral integrity, language and truth itself." He left Spain a committed anti-communist — and lifelong adversary of Stalin's defenders — and spent the World War II years back home in England. In 1946, Orwell moved to the island of Jura, where, at the age of 45, he completed *1984* shortly before succumbing to tuberculosis.

Lynskey focuses much of his book on the origins and the afterlife of *1984*. He devotes several early chapters to the rise of utopian and dystopian fiction, told through compressed portraits of figures like H G Wells (who "loomed over Orwell's childhood like a planet") and Yevgeny Zamyatin, the author of *We* — a sort of precursor to "1984." And he documents the various political and cultural responses to the novel, which was a sensation from its first publication.

1984 has inspired writers, artists and other creative types, from Margaret Atwood to David Bowie to Steve Jobs, whose commercial introducing Apple's Macintosh computer famously paid homage to the novel. Its political fate, however, has been somewhat cloudier. What Orwell observed of Dickens, that he is "one of those writers who are well worth stealing," has proved no less true of Orwell himself. Socialists, libertarians, liberals and conservatives alike have vied to remake him in their own image and claim his authority.

Lynskey largely refrains from participating in the quarrel over Orwell's and his novel's true teachings and rightful heirs. If anything, *The Ministry of Truth* can seem too remote at times from its subject matter.

Nor does Lynskey illuminate the literary or intellectual qualities that distinguish Orwell's novel from its many predecessors and descendants in the dystopian genre. In short, while we learn a great deal about the evolution and influence of *1984* as a cultural phenomenon, we sometimes lose sight, in the thick of Lynskey's historicising, of the novel's intrinsic virtues — of what makes it distinctive and accounts for its terror and fascination in the first place.

Lynskey is surely right, however, to note that the meaning of Orwell's novel has shifted over the decades along with the preoccupations of its readers; and that in our low, dishonest moment, it is "most of all a defence of truth." Reflecting back on the Spanish Civil War and the falsification of its record, Orwell worried that the "very concept of objective truth is fading out of the world." Yet he never seems to have resigned himself completely to hopelessness.

Winston Smith, the doomed protagonist of *1984*, inhabits a world in which individuality has been made almost obsolete, history is daily rewritten and reality is fabricated according to the whims of the state. Winston attempts, despairingly and bravely, to rediscover what life was like before the rise of Big Brother. He is shocked that his lover, Julia, is indifferent to the state's assault on truth — the unreality of the present is all she has known and all she believes ever was or will be. Her complacency is the counterpart to Winston's energising despair. In this way, *1984* elevates despair into a sort of necessary condition of truth-seeking. It is here if nowhere else, Orwell suggests, that hope for humanity may lie.

THE MINISTRY OF TRUTH
The Biography of George Orwell's "1984"
Dorian Lynskey
Doubleday; $28.95; 355 pages