Accelerating formalistion

India has become more formal job friendly with recent ESIC reforms

MANISH SABHARWAL & RITUPARNA CHAKRABORTY

In 1965 Professor Milton Friedman warned India that the Mahanalobis economic model being adopted "threatens an inefficient use of capital by combining it with too little labour at one extreme and an inefficient use of labour by combining it with too little capital at the other extreme". Unfortunately he was right; a dysfunctional labour law regime over the next 50 years ensured that most of our 6.3 crore enterprises have created informal jobs with low productivity that pay low wages. Much regulatory cholesterol still exists but last week's repricing of health insurance premiums to reflect costs for the Employee State Insurance (ESI) is an important labour law reform will accelerate enterprise formalization and social security penetration.

ESI is often insultingly described as self-financing; unclear what that means because ₹22,000 crore was confiscated from employee salaries last year by the Employee State Insurance Corporation (ESIC). More painfully, ESIC only paid out 50 per cent of the contributions it collected as benefits. This overcharging has not only lead to an unacceptable ₹75,000 crore cash hoard, the revision of contribution rates from 6.5 per cent to 4 per cent will reduce employee salary confiscation for low wage employees— the only kind covered by ESI — by about ₹7,000 crore. This tweak is not an argument against ESI but an acknowledgement of Renaissance physician Paracelsus's warning "The dose makes the poison". Anything powerful enough to help has the power to hurt if administered in the wrong proportion.

This revision to contribution rates for the first time in 20 years is important for many reasons. It recognises that there is no reason to be accumulating huge amounts of cash confiscated from employees. It recognizes that past contribution rates have been higher than required. It recognises that in a cost-to-company world of compensation, salary is the property of employees. It recognises that an unreasonable gap between *chitthi-waali* salary (gross) and *haath-waali* salary (net salary in hand) breeds informal employment. It recognises that an appetite to take on vested interests. It recognizes that social security reform is an important component of labour reform.

This scepticism about ESI is not cynicism about social security; a modern state is a welfare state and spreading India's prosperity needs a well designed and sustainably financed safety net. However, ESI's accountability for outcomes is weak even for plumbing problems; the portal is down often, hard copy requirements exist, hospital visit are often required for photos and doctor signatures, a six month block instead of three months or real time, challenges in transferring contributions and merging numbers, moving away from sub-code wise remittance, disconnect between branch offices and dispensaries, portal unable to accept accidents reports for the last three months, address of new dispensaries yet provided in portal, unclear procedure for correction of names, Joint undertaking procedure not implemented, and much else.

Over the decades ESI has had weak oversight; what else explains the board not fixing excessive contribution rates and poor dispensary service? The only sustainable fixes are competition and governance. Sustaining reform will need governance overhaul; the current board of ESIC is too large (58 members), has too many generalists (no specialised sub-committees), is a geriatric ward (no age limits), has too little turnover among members (no term limits). The board does not think strategically about the Institution of ESI (the provision of health insurance) and ESI as an Institution (its human capital, technology, training, performance management, structure). ESIC needs competition; we must implement the previous NDA budget announcement that employees can choose who manages their premiums. Maybe we should merge CGHS with ESIC; nothing improves services more than getting rid of VIP rooms, lanes and access. If that is not acceptable, a second best choice may be merging ESIC with Ayushman Bharat; a medical rather than trade union "thought world" is better for contributors. ESI's dysfunctionality is demonstrated by only enrolling 12 lakh of India's 6.3 core enterprises over 70 years. GST enrolling the same number of enterprises within two years demonstrates that design is a powerful lever.

Dr. B. R. Ambedkar - whose 1943 report laid the foundations for the ESI Act in 1948 - said "A great man is different from an eminent one in that he is ready to be the servant to society". ESI's greatness comes from its monopoly rather service to society via capabilities, outcomes, and politeness. This must change. Social security is vital infrastructure but blindly copying the West without their incomes or recognizing the current problems of their safety nets is delusional. Important design issues for ESI - who pays, who delivers, who governs - need further review because an unintended consequence of past design is widespread low productivity employment with most Indian enterprises being dwarfs (small that will stay small) rather than babies (small that will grow). With few formal employers, there are few formal employees. Thankfully recent ESI reform indicates a willingness to deal with the labour laws that don't protect employees and discourage formal employment.

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CHINESE WHISPERS

Bickering over sport

Kerala seems to be moving towards a legal framework to make *Kaalayottam* (bull race), *Kaalavayal* (bullock-cart race) and *Maramadi* (cattle race) legal. A private Bill has been tabled in the Assembly by MLA Anup Jacob. The Bill claims these are an integral part of the state's agrarian culture and do not involve cruelty against animals. Reports suggest the government is keen on the Bill being passed without a hassle. The government's alacrity is understandable, given the furore surrounding *Jallikattu* in neighbouring Tamil Nadu, where the sport was approved through an Act by the Assembly. If this Bill is passed, it would undo a Kerala High Court order in 2015, which said that the Centre's notification prohibiting the use of bulls as "performing animals" was applicable to sports like *Maramadi*.

First day, first show

On the first day of the 17th Lok Sabha, Members of Parliament turned up in their state or community's traditional attires, shawls and headgear, while a section wore saffron. Bihar MPs Gopal Jee Thakur and Ashok Kumar Yadav came in traditional Maithili attire and headgear, while most of the Assam MPs donned traditional Assamese *gamocha*. YSR Congress MPs from Andhra Pradesh had their *Angavastram*, dotted with the picture of party chief and Chief Minister Y S Jagan Mohan Reddy. Arunachal Pradesh MP Tapir Gao wore the traditional blue Arunachali jacket. Secretary General of Lok Sabha Snehlata Shrivastava by mistake called Petroleum Minister Dharmendra Pradhan to take oath and soon rectified it as the latter is a Rajya Sabha Member.

No *samadhi* for Vairagyanand

A priest in Bhopal was just going to take *samadhi* (a state of deep meditation) on Sunday when the police moved in to thwart his plan. Vairagyanand Giri had predicted that in the Bhopal Lok Sabha elections, the victory of Congress leader Digvijaya Singh was just a formality. He had also said if, on the outside chance, Singh lost he would take *samadhi*. After Singh conceded defeat to Sadhvi Pragya Thakur of the Bharatiya Janata Party, Vairagyanand Giri was untraceable for a while. At some point, he wrote to Bhopal Collector Tarun Kumar Pithode, requesting him to allow him to fulfil his promise. Pithode rejected the request and asked the police to ensure nothing untoward took place. In a statement Vairagyanand later said, "The *yagna* has failed. I respect the mandate of the people."

A slowdown for smelters

Reduced concentrate output globally and heightened demand from Chinese smelters are to adversely affect the supply of feedstock for Indian smelters

KUNAL BOSE

TAKE TWO

The close to 1-million tonne (mt) Indian copper industry has three constituents, of which the biggest Hindalco has a 500,000-tonne smelter in Gujarat's port city of Bharuch. Vedanta's 400,000-tonne unit at Thoothukudi in Tamil Nadu has remained inoperative since March 2018 — first for plant maintenance and then the local government ordering its closure for causing damage to the environment. Of the three, the 76.05 per cent government-owned Hindustan Copper Limited (HCL) is alone vertically integrated from mining of ore to smelting to making value added continuous cast (CC) rods.

As Hindalco and Vedanta do not own mines in the country, their reliance on imports of metal in concentrate (MIC) for its smelting into refined copper is total. But this is quite a common global practice with Japan making around 1.5 mt of refined copper based on copper concentrate imports. China, which stepped up copper production by 8 per cent to 9.03 mt in 2018, made record imports of 19.72 mt of concentrate, up 13.7 per cent over 2017. When standalone smelters such as those belonging to Hindalco and Vedanta import MIC for smelting, they get treatment and refining charges (TC/RCs) from mining groups. TC/RC, negotiated between mines and the global smelting industry, is a discount given by mines for conversion of concentrate into refined copper. TC/RCs are, therefore, a principal source of revenue for smelters. Production of value added CC rods in the downstream, an area of strength for Hindalco is also an important revenue stream for smelters.

There is an established pattern to setting TC/RCs on an annual basis at negotiations, invariably intense, held between major miners and smelter owners during the LME week every October and also during Asia Copper week in November, the latter is more focussed on Chinese copper producers. While TC/RCs thus fixed are taken as benchmark for copper concentrate supply contracts for the whole of the following year, a number of factors such as availability of concentrate, which in turn depends on mines in operation in major copper ore producing countries such as Chile, Peru, Zambia and Indonesia and global smelter capacity in operation. Dynamics of TC/RCs are particularly in focus this year.

Spot TC/RCs for Asia Pacific are down to their lowest in at least six and a half years, squeezed by ramp-up of MIC consumption by smelters against a backdrop of tightening supply of the smelter feedstock. Worryingly for smelters, which find their margins already squeezed, spot TC/RCs look set to stay under pressure. At the current TC/RCs, there is a major climbdown from January's $90-$94 a tonne. Hindalco Managing Director Satish Pai has said during a recent earnings conference call that copper concentrate market will likely see a deficit of around 100,000 tonne in 2019. This is to happen because of reduced production at several regions. Grasberg copper mine in which the Indonesian government had acquired 51 per cent ownership, previously majority-owned by Arizona-based Freeport-McMoran is having major production problems as the authorities have laid down rules for disposal of tailings, which are proving to be too difficult to honour.

Grasberg, which is the world's second largest copper mine and unarguably the most complex of all mines with its main pit being at 4 km above sea level is far from finding an economically feasible solution to tailings disposal. This big Indonesian mine apart, Chile's Codelco, the world's top copper miner, reported an 18 per cent year-on-year fall in its first quarter copper production. What could further tell on Codelco production are the unresolved industrial problems. Zambia is coming down hard on miners found to be in breach of environmental and financial regulations. According to Pai, the issues concerning mines in three continents and also the prospect of the "majority of smelters that experienced disruptions in 2018 being fully ramped up" are likely to lend "tightness to concentrate market in the second half of 2019." The combination of "reduced concentrate output and heightened demand from Chinese smelters is likely to adversely affect TC/RC values at the spot level," he says. When will the Vedanta smelter reopen remains anybody's guess. But whenever operations start at Thoothukudi, there will be some extra pressure on TC/RCs, which move in tandem with concentrate supply situation and demand for smelter feedstock.

Not only are the majority of Chinese smelters back in business following their maintenance shutdowns but new smelting capacity of about 400,000 tonnes has been commissioned in the country that accounts for half the world's copper use. A major concern for the industry is the likelihood of deceleration in global copper ore supply growth as operating mines contend with rising production costs resulting from systematic grade declines and resource depletion, says a DBS Asian Insights report. At the same time, low exploration in recent years is limiting new discoveries. DBS forecast is "global mine production will grow at a CAGR of 2.9 per cent" up to 2022.

In the face of tightening of global supply of ore, the demand for copper in India will continue to grow at a healthy rate of around 8 per cent. This is as it should be since this country with a per capita consumption of 0.6 kg is way behind China's 6 kg and the global average of 2.7, says Santosh Sharma, chairman of HCL. What copper concentrate HCL makes is good to take care of about 5 per cent of national demand. This being the context, Sharma believes that by pulling out all the stops to achieve ore production to 20.2 mt in the next six years from 2018-19 output of 4.122 mt, which yielded 32,439 tonnes of concentrate, HCL will cement its long-term viability.

ON THE JOB

Young women return to labour markets

MAHESH VYAS

Labour statistics from CMIE's Consumer Pyramids Household Survey for the period January-April 2019 shows a perceptible increase in the labour force participation rate of women in the age group 20-24 years.

Female labour participation rate in this age group was 13.4 per cent during this period. This is the highest female labour participation rate in this age group since the September-December 2016 survey. We believe that this is a significant development.

Female labour participation rates had fallen across age groups after demonetisation in November 2016. The overall ratio has not recovered since, from its pre-demonetisation level which was around 16 per cent. Prima facie, the adverse impact of demonetisation on female labour force participation rate continues.

During the January-April 2019 survey, the overall female labour force participation rate was down to 11 per cent. But, this survey also contains signs of a possible turnaround.

To avoid any effects of seasonality, we compare the female labour force participation rate during January-April 2019 with the rates during January-April 2018, January-April 2017 and with the pre-demonetisation period of January-April 2016.

During January-April 2016, the female labour force participation rate was 15.7 per cent. This fell to 12.7 per cent in the same months of 2017 and then 11.4 per cent in 2018 and now to 11 per cent in the same four months of 2019.

This fall in female labour participation rate was almost across all five-year age groups. We say almost because between 2016 and 2017, there was one exception. In the age group 55-59 years, female labour participation rate did not fall but it rose by 0.18 percentage points. In subsequent surveys, this age group showed substantial fall in the female labour participation rate — by 2.1 and 1.2 percentage points in the 2018 and 2019 survey, respectively.

In 2018, while all age-groups showed a fall in the female labour participation rates, the age-group 20-24 years did not show a fall. It increased, albeit negligibly, by 0.02 percentage points. The two neighbouring age-groups — 15-19 years and 25-29 years showed a fall in the participation rate by 0.6 and 0.7 percentage points. The increase in female labour participation rate was in the age-group 20-24 years. It was too small an increase and was hemmed by other groups that did not show an increase.

But, 2019 shows that the small increase seen in 2018 was possibly an early sign of a turnaround. The 20-24 year bracket is a vital age-group when young people join the labour force. Any significant increase in this young age-group is therefore important.

The female labour force participation rate of the 20-24 age group increased by 2.5 percentage points from 10.9 per cent during January-April 2018 to 13.4 per cent during January-April 2019. This is significant.

The two neighbouring age-groups also show a small increase in the participation rates. The young 15-19 years age group showed an increase in its female participation rate by a negligible 0.05 percentage points. But, the increase in the 25-29 years age-group is much better at 0.25 percentage points — from 13.04 per cent to 13.29 per cent.

Evidently, young women are returning to the labour markets.

There is still some distance to travel, though. The labour force participation rate of women in their twenties was around 17.5 per cent in early 2016. In early 2019, it was less than 13.4 per cent.

There are two related positive signs regarding female labour force participation rates in the CPHS results of early 2019. First, the fall in female labour force participation rates in 2019 over 2018 is much lower than it was in 2018 over 2017. This is true of all age-groups. And second, the fall in labour participation rate among younger women is much lower than it is among the relatively senior women.

While it is heartening to note the return of young women into the labour markets in greater numbers, it is important to highlight the challenges they face in finding jobs. The unemployment rate among young entrants into the labour force is usually high. But, in the case of 20-24 year old women it is exceptionally high. And, the unemployment rate for these also increased sharply in early 2019 compared to the level in early 2018.

The failure to provide jobs to these young women may discourage new cohorts from entering the labour markets. The economy needs to meet the aspirations of its young labour force that is keen to work.

The author is the MD & CEO of CMIE

LETTERS

Gold standard

This refers to the report "RBI joins peers to buy gold insurance" (June 17). While it is comforting to note that the RBI is augmenting the gold component in India's foreign exchange reserves, efforts to account and mainstream the country's domestic gold stock are not moving fast. This should be done urgently as the measure will bring down the need to import gold which is a drain on our precious forex reserves.

According to media reports, recently the Guruvayur temple in Kerala decided to deposit 350 kg out of its gold stock with the State Bank of India; this deposit will earn 8.75 kg gold per annum as interest for the temple. Surprisingly, the gold will have to be transported all the way to Mumbai for refining and standardising to be accepted as deposit by the SBI. Earlier also, the temple had deposited gold with the bank. Other temples like Tirupati and Siddhivinayak (Mumbai) have also deposited part of their gold stocks with banks. One single deposit of Tirupati earns per annum interest equivalent to the value of 80 kg gold.

To make gold deposit schemes popular, measures like starting facilities for refining and certification of standards, building public trust in such schemes and incentives for accounting and mainstreaming gold stocks beyond a threshold level with institutions and individuals will be necessary.

M G Warrier Mumbai

Involve pvt sector

This refers to the article "Navy finds defects in Scorpene" (June 15). It is unfortunate that despite three decades of experience in submarine construction, public sector shipbuilder Mazagon Dock Ltd. is unable to meet minimal operational and safety standards. It is imperative for the government to involve the private sector in the submarine and warship building programmes for the Indian Navy. This is also a good opportunity to revive several private sector shipyards, which were booming just a decade ago but are languishing now due to a lack of new orders. Several yards are undergoing the insolvency resolution process, but are unable to find suitable bidders primarily due to lack of orders.

It would be a wise move to reserve fresh naval orders for the private sector in order to attract leading players in the heavy engineering sector from India as well as abroad to bid for these stressed assets. Fortunately, the state of the art infrastructure commissioned by private sector yards during their peak years is intact. This would also fit in well with the government's objective to reboot the economy. The experience of China and South Korea has established that compared to other industries, the shipbuilding sector has the highest economic multiplier effect on jobs, investment and growth of ancillary industries. .

S B Bhalerao Mumbai

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HAMBONE

Business Standard
Volume XXIII Number 218
MUMBAI | TUESDAY, 18 JUNE 2019

Don't overprice

5G spectrum pricing can't be at the cost of the industry

The ball is in the telecom regulator's court once again to decide the course of the industry at a challenging juncture. Last week, the Digital Communications Commission (earlier Telecom Commission) had asked the Telecom Regulatory Authority of India (Trai) to review its 5G spectrum recommendations of August 2018, including the steep reserve price set by it then. While the DCC, the highest decision-making body in the government on telecom, took the right step in sending the one-year-old recommendations back to the regulator, keeping in view the stressed financials of the telcos and the overall low-key investment climate, it's up to Trai now to show the way by not falling for the temptation of revenue maximisation for the government. The regulator should rather look at the health of the telecom industry, which is saddled with debts of ₹4.3 trillion, rather than trying to get a big buck from the auction, to be spread across bands, including 3,300 to 3,600 MHz for 5G services.

It's true that the spectrum money is a major revenue source for the government facing a difficult fiscal situation. But Trai's primary responsibility is to ensure the industry does not go down further through extravagant bidding and that the element of competition remains. Established in 1997 by an Act of Parliament after the entry of private service providers, the stated mission of Trai is to create and nurture conditions for the growth of telecommunication. More importantly, it has to "provide a fair and transparent policy environment which promotes a level playing field and facilitates fair competition". Trai must not ignore its mandate.

At the current reserve price for spectrum, across multiple frequency bands recommended by Trai for the upcoming auction this year, the government could mop up around ₹5.83 trillion ($83.8 billion). But telcos, already caught in a tariff war after the entry of Reliance Jio and its disruptive pricing, could see a further erosion of their earnings if spectrum price, considered among the highest globally, is not brought down. Recent consolidation has resulted in making telecom a three-player industry, which once had more than 10 participants. Any further consolidation or exit will mean the telecom industry will be left with no competition. India cannot afford that scenario.

The aggressive bidding by telcos during the 3G auction in 2010 was the starting point of the industry's decline. By 2016, when telcos were already bruised and had a substantial debt pile, they exercised restraint — the spectrum sale ended in just five days and the government could raise only ₹65,789 crore revenue against ₹5.63 trillion (base price) worth of spectrum put up for sale. If telcos do what they are claiming, the next auction could be a repeat of the 2016 flop show. Two leading companies, Bharti Airtel and Vodafone-Idea, have said they will not participate in the 5G auction at the current reserve price of ₹492 crore per megahertz. According to telecom industry estimates, the recommended base price is 30-40 per cent higher than the rates in markets like South Korea and the US. If the 5G price is not reduced and two top players opt out, it will spell the end of a level-playing field in telecom for years. It's the turn of both Trai and the government, which has the powers to reject the recommendation of a regulator, to act responsibly.

Misplaced sub-nationalism

Mamata Banerjee's latest gamble suggests desperation

When she came to power in 2011, Mamata Banerjee had vowed to change West Bengal: *Poriborton* was the Bengali word she employed in a campaign that unseated the Left Front. Now, having created the conditions for the Bharatiya Janata Party (BJP) juggernaut to make significant inroads in the state by polarising the electorate on religious lines for no good reason, she has chosen to interpret her next challenge in the narrowest possible terms, by invoking Bengali sub-nationalism. Those living in West Bengal would have to learn to speak Bengali, she told a gathering three days ago in a district in south Bengal. Her motive was transparently to identify the BJP with a northern, Hindi-speaking hegemony. Her calculation is that since Bengali speakers account for over 85 per cent of the state, her appeal would act as a cultural rallying point.

If anything, Ms Banerjee has displayed a unique tone deafness. First, the "Hindi/Hindu" identity has patently not deterred Bengalis from voting for the BJP in larger numbers, delivering 18 seats from just two in 2014. Second, she has misunderstood the nature of Bengali sub-nationalism. It is true that Bengalis harbour an elevated sense of cultural pride. The average Bengali will never fail to remind others that her state boasts two Nobel prize winners (Rabindranath Tagore and Amartya Sen), one Oscar winner (Satyajit Ray) and the writer of India's national anthem (Tagore), and a scientist whose name was hyphenated with Albert Einstein (Satyendra Nath Bose) in a famous discovery. Little of this, however, has translated into parochial or nativist predilections. This is principally because the icons of Bengali politics and culture cultivated a national and internationalist outlook.

No one embodies this multi-culturalism more than Bengal's most famous son, Tagore. But even if he were excluded, the list of those with a similar outlook is long and varied: Swami Vivekananda, who contributed to the concept of nationalism in colonial India; Rammohan Roy's Hindu revival movement, which drew on the monotheism of Christian Unitarianism; Bengal School artists such as Nandalal Bose, who incorporated Japanese influence into his unique *oeuvre*; Ray, who admitted to being influenced by Hollywood; Subhas Bose, whose progressive, inclusive politics was ahead of its time. In post-independent India, cultural politics has never been a factor at the hustings, and Ms Banerjee may find herself playing into the BJP's hands if she chooses to invoke it now.

In this respect, she also appears to have a short memory. Just two years ago, her insistence on imposing Bengali in Darjeeling violently revived the movement for a separate Gokhaland. The agitation brought the region to a standstill, impacting tourism and practically destroying that season's tea crop, the state's biggest export earner. Ms Banerjee was forced to backtrack, but should she choose to pursue her linguistic chauvinism anew, Darjeeling could erupt again, adding to the cycle of political violence that is disrupting life in the state. This attempt to rally her base is the latest in a series of mis-steps by Ms Banerjee in countering the BJP. They bear all the hallmarks of desperation and ideological bankruptcy. She urgently needs to come to her senses if what little hold she has over her state and her people is not lost.

ILLUSTRATION: BINAY SINHA

A question of trust

For investors to return to NBFCs, trust needs to be rebuilt in the financial system and its guardrails

There has been a degree of surprise among observers as to why the NBFC crisis continues to simmer and even worsen. Both NBFC (non-bank financial company) and HFC (housing finance company) stocks were darlings of the markets before the IL&FS default. They were growing very strongly, had good profitability and were beneficiaries of the deepening money and credit markets. At one time, they accounted for almost 25 per cent of the incremental credit growth in the system. The stocks were rewarded with high multiples and were seen as following the same value creation path delivered by the private banks previously.

AKASH PRAKASH

If these stocks were among the best performers pre September 2018, why is no one willing to buy the sector (bar a handful of companies with strong industrial house backing) today, despite many of these stocks being down between 50 per cent and 75 per cent?

The reason for investor apathy is that there is a total break down of trust in the system. Public market investors do not have access to the books of these financial companies. In the absence of being able to see the loan books themselves, public market investors have to rely on external agencies for confirmation of asset quality, governance etc. It is here that there is a total break down of trust.

Post the IL&FS debacle, rating agencies have lost credibility. How was this highly leveraged and complex giant allowed to remain at AAA or even AA+ for so long? It was only downgraded after defaulting. On what basis were such high ratings given? What about surveillance and monitoring of the ratings? The credibility of the rating agencies was damaged even further once other large NBFCs (many of whom were rated AAA) were also downgraded to non investment grade and in some cases straight to default. Some of the downgraded institutions have a large quantum of retail fixed deposits and even retail debentures outstanding. Public market investors are currently not willing to take the ratings provided by the agencies at face value. Who knows which institution will get downgraded next? The slew of downgrades seems to indicate that IL&FS was not an isolated incident.

Many institutions which are facing short-term liquidity issues despite reasonable ratings, are suffering from this ratings distrust. In a normal environment, they should have access to liquidity. Yes, there are asset liability mismatches, but everyone does not have a solvency issue. The lack of trust in the ratings is choking off liquidity.

Another similar issue is also with the top auditors in India. All four of them have been caught in one controversy or another. If I am not mistaken, it may be possible that for the coming year none of the top four auditors will be allowed to audit a scheduled commercial bank. Again, there seems to have been serious accounting irregularities at IL&FS. If you can't trust the competence of the auditors, how do you believe the numbers they are signing off on? If you can't trust the accounts, how do you know what is the real asset quality or profitability of the institution. You also have the spectacle of audit firms suddenly resigning from the companies they have been auditing for years. They can resign in a day, but what happens to the shareholders or lenders to these firms? They are left holding the can, as they cannot exit with the stroke of a pen.

The guardrails of the financial system. Rating agencies and auditors, both are under a cloud at the moment. In the absence of trust in these guardrails, investors will need to see the asset books of the NBFCs and HFCs themselves and come to their own judgement about asset quality and profitability. Public market investors do not have access to the books. We have to rely only on publicly disclosed and available information. In the past, when there was no trust deficit, we could rely on this publicly disclosed information to make investment decisions. There was faith in the quality of the information provided. With trust in the rating agencies and audit firms, there was no need to second guess everything. Today, it is different. The rumours and noise surrounding certain NBFCs also add to the confusion and climate of fear. It is very difficult to think calmly, deploy capital and invest in these leveraged financials when you worry about the accuracy of the numbers and ratings which are in the public domain.

The only way out of this mess, in the short term is for private equity to step up. The private equity shops can ask for access to the books and take the time to do the diligence. They have the ability to see the numbers in much greater detail than public market investors. If a credible private equity shop were to invest in one of these stressed NBFC/HFC, it would add credibility immediately and would crowd in investment from other investors. The investment would signal that what you see is what you get and that we can trust the numbers. The extent of recapitalisation will provide the growth capital needed and reopen access to liquidity.

The other alternative would be for the regulator to do a stress test on the books of these troubled financial institutions. Lay out the assumptions used in terms of stress parameters and disclose the quality of the underlying book. What are the real NPAs? What capital hole, if any, needs to be filled under the stress assumptions used (stress assumptions could be an economic recession, fall in real estate prices, rise in rates etc).

Such a stress test, blessed by the regulator, will give investors confidence around the actual condition of the asset books of many of these NBFC/HFCs and allow investment decisions to be made on hard analysis and not fear.

There is too much gossip around this sector. Every day one hears rumours about one institution or another in trouble. People are worrying about career risk when either lending to or investing in these financial companies. You have a liquidity crisis which is now morphing into a solvency crisis. The only way to kill these rumours is to have a stress test on the asset quality of the troubled institutions. This will stop all the rumours and reopen access to capital for those select institutions which are being unfairly penalised by the markets due to the current environment of distrust.

What started out as a liquidity crisis is now becoming a solvency issue. NBFC/HFCs are being forced to desperately sell good retail assets to maintain repayments. Many have been denied liquidity now for eight months. They have almost entirely stopped lending, with inevitable consequences for the economy. Most will have to be recapped and given new equity. This can only happen if trust is rebuilt in the system and its guardrails.

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How serious is the NBFC crisis?

The Reserve Bank of India's monetary policy statement of June ticked all the right boxes. It delivered the predicted 25 basis point policy rate cut. It said the policy stance had moved from "neutral" to "accommodative", which suggests that further rate cuts could be in the offing. It mentioned that the system had moved to surplus liquidity in June.

But nagging questions remain. One is whether liquidity is adequate to ensure complete transmission of the cumulative cut in policy rates of 75 basis points over the last three monetary policy statements. Out of the 50 basis point (bp) cut in the policy rate prior to the latest statement, 40 bp has been transmitted to the yield on 10-year government securities. However, only 21 bp has been transmitted to the weighted average lending rates.

FINGER ON THE PULSE

T T RAM MOHAN

The RBI Governor said "adequate" liquidity would be available in the system for all productive purposes. What is adequate liquidity? The central bank appears to be guided by the call money rate, whether it is close to the repo rate or not. This may not be the right indicator for judging liquidity in relation to economic growth.

The call money rate could be low because a few large banks have excess funds while small banks cannot borrow beyond a point because of limits on overnight borrowings. Banks may be able to borrow but they cannot lend because they lack enough regulatory capital. The time may have come to provide a liquidity target that the market can readily track and that reflects the growth needs of the economy. The old-fashioned would swear by M3, the broad measure of money supply. Why not restore it? Or provide an equivalent indicator?

Another troubling question: Is there enough liquidity to ward off financial instability? For several months now, the markets have been jittery about systemic risks posed by NBFCs. The jitters have increased following the downgrades of two well-known NBFCs. The RBI doesn't seem to share the markets' nervousness. The policy statement makes no mention of NBFCs. The RBI has made clear time and again that it does not believe in providing any special liquidity window for NBFCs. It has preferred to focus on overall liquidity and has left it to banks to channel funds to NBFCs on merits.

In his interaction with the media, the RBI Governor seemed to exude a certain confidence about the RBI's assessment of the sector. The RBI, he said, was monitoring developments and was committed to ensuring a "robust, well-functioning NBFC sector". It would take steps required to ensure that developments in the sector did not impact financial stability. The media discerned in the statement echoes of ECB President Mario Draghi's famous quip about doing "whatever it takes" to protect the euro.

So far, the RBI's assessment about the NBFC sector has turned out to be correct. Doomsayers had forecast a "Lehman moment" on account of NBFCs last October. We survived. Then they said that the NBFC sector would have to cross a hump in May. No sign again of a systemic crisis.

If the RBI thinks it has a grip on financial stability, that's great news. But it's not enough that the system doesn't go belly up. Economic growth is flagging. Since NBFCs cannot grow credit as in the past, banks have to fill the gap. Ensuring liquidity is only one part of the story. The other part is providing adequate capital to public sector banks. The big question is whether the finance minister can muster the necessary capital without help from the Bimal Jalan committee on the RBI's economic capital framework.

Mr Subramanian's bombshell

Arvind Subramanian's working paper highlighting the over-estimation of GDP growth in the period 2012-16 has proved less explosive than it seemed at first sight. For a couple of days, habitual BJP-baiters had a field day claiming that the government's economic achievements had been inflated. (They seemed to overlook the fact that three out of the five years covered by Mr Subramanian's findings pertain to the UPA government). But the initial shock at being told that the Indian economy had been reduced to 4.5 per cent crawl seems to have dissipated.

You can't ascribe it entirely to astute media management. Had the findings been credible, foreign investors would have reacted. If India is not the fastest growing large economy, it undermines a key premise on which India has been attracting capital flows. We would have heard from investors, investment bankers and rating agencies. There's been a resounding silence.

A fair inference is that the markets are reluctant to buy Mr Subramanian's thesis. Leaving aside methodological issues, Mr Subramanian doesn't tell us what went wrong in 2012-16. What economic shock caused growth to slump to an average of 4.5 per cent after decades of higher growth?

One plausible factor is the as yet unresolved banking crisis. The Economic Survey of 2016-17, prepared during Mr Subramanian's stint as chief economic adviser, entirely discounted this factor. The Survey noted that, unlike in the US, Europe and Japan, "..... it (the twin balance sheet problem) co-existed with strong levels of aggregate domestic demand, as reflected in high levels of growth..." This was more than two years into Mr Subramanian's term.

Mr Subramanian might have circulated his paper more widely amongst academics and amongst the government's agencies and invited a critique before publishing it. His rushing into print with findings that are potentially damaging to India's economic standing has not helped the cause of Indian economists.

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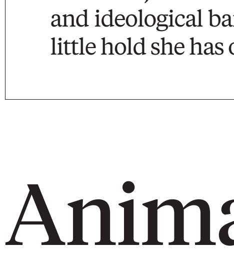
Animal lovers



KITABKHANA

T C A SRINIVASA-RAGHAVAN

Book wise, the last six months have been very lucky for me. I have constantly discovered new authors and wonderful books.

First, I found the mystery crime thriller writer, Sujata Massey. Her stories are situated in the Bombay of the 1920s.

Then I found that extraordinary book on the Great Indian Hedge by Roy Moxham. He found that British customs had planted a 2,300 mile-long hedge to prevent the smuggling of salt between British India and Indian India, that is, the princely states.

And last month I chanced upon a book by Radhika Govindarajan, a young anthropologist who teaches in the US. Its title, *Animal Intimacies* , is what drew my attention. It is about the sociological aspects of the relationship between humans and animals in India and is absolutely fascinating, aside from being well written.

Indeed, it reminds me of another book that I came across in a library in Korea in 2013 by the Princeton anthropologist, Marvin Harris. It was called *Cows, Pigs, Wars and Witches*.

Mr Harris had argued in that book that people always do something for rational reasons that are grounded in the socio-economic context. Ms Govindrajan, however, doesn't refer to this book. But she does mention a paper by Mr Harris in the bibliography.

Nit-picking aside, this is a seriously good book which all Indians who know English should read. After all, under the new dispensation, animals have acquired a new halo — we are being asked to do things vis-a-vis animals for political reasons as well. Ms Govindarajan discusses this in her chapter on cows.

The other chapters are on monkeys, goats, bears and pigs. It seems each of these animals has a special place in the overall scheme of things.

Swadeshi versus foreign cows

The people of Uttarakhand, at least where Mr Govinndarajan carried out her studies, seem to believe that the Indian *pahari* cow is superior to the imported Jersey one, even though the latter yields more milk and is generally stronger. The *pahari* cow, however, is endowed with divine *shakti* such that it is to be always preferred to the foreign one.

That said, when it comes to slaughter, neither is to be offered up because a cow is a cow and woe be to the nation that allows them to be slaughtered. These are such deep-rooted beliefs that Ms Govindarajan can find no rational explanation for it. She dismisses Marvin Harris's explanation about what economists call value-in-use. It has to be something more she says but is unable to tell us precisely what that something more is except that the *pahari* people and the *pahari* cows have a special relationship.

The people of Uttarakhand, at least where Mr Govinndarajan carried out her studies, seem to believe that the Indian *pahari* cow is superior to the imported Jersey one, even though the latter yields more milk and is generally stronger

All that she is able to find out is that there is a bias in favour of the *pahari* cow such that even the cows from the plains are not seen as being comparable. So the prejudice is not just Indian versus Foreign but also *pahari* versus non-*pahari*.

There's something else I learnt: Upper caste people in Uttarakhand who would not sell *pahari* cow milk to the Dalits, had no problem selling them Jersey cow milk.

Bear truths

The chapter on bears is a real zinger. It seems women in Uttarakhand's villages tell stories how bears make off with women and "do to them what men do to women".

If this sounds outlandish, Ms Govindarajan says similar stories can be found in the West also. Indeed, she quotes a man called Edward Topsell who wrote about this inter-species lovemaking in detail. Bears, he said, were of "lustful disposition" and did it like men.

But once again, as with the cows, this kind of relationship between humans and animals seems to have no comprehensible explanation. What's more, these stories are all mostly in the female domain. The men know about them, of course, but it is the women who talk about bears, sometimes to shame men into doing to them what the bear will do to them. The bears, of course, are better endowed.

One woman told Ms Govindarajan the following about what her grandmother had told her: "She (the grandmother) said they were doing it for an hour. She saw the whole thing. The sounds!... She said the bears don't get tired. They keep doing it, keep doing it, keep doing it."

Another woman told her: "Just think what if they were to do that to one of us. I would die of exhaustion if he were on top of me for three days".

Anyone would, I guess.