Opinion

TUESDAY, JULY 30, 2019

DEVELOPING NATIONS & WTO

President of USA, Donald Trump

"The WTO is BROKEN when the world's RICHEST countries claim to be developing countries to avoid WTO rules and get special treatment. NO more!!!"

RationalExpectations

SUNIL JAIN
sunil.jain@expressindia.com
@thesuniljain

Modi needs an economics minister

If the prime minister is to drive the economy, it can't be done without more in-house economics expertise

THERE IS LITTLE to be gained by speculating over what exactly it was that led to Subhash Garg losing his job as the finance secretary, the most powerful bureaucratic post in the country after the principal and cabinet secretary. It can't be the decision to raid the RBI's reserves since, even though that has been criticised by most economists as well as ex-RBI officials, this is something that Arvind Subramanian came up with when he was chief economic advisor; also, while Garg may have pushed for the idea of threatening RBI by holding the consultations under Section 7 of the RBI Act, everyone in the government was aware of this. Nor can it be the decision to issue a sovereign bond that resulted in Garg falling out of favour since finance minister Nirmala Sitharaman has just said there is going to be no change in the plan.

The short point is that everyone in the government—including the PMO that played a larger than usual role in the budget's formulation—was fully briefed about the issues, and their pros and cons. And while it is true the super surcharge on the rich, and the FPIs as a result, was a big disappointment for those looking for tax cuts—especially in corporate taxes where India's effective tax rates are nearly double those of our competitors, like China—there is a whole lot more that is ensuring investment levels continue to fall, so the problem goes much deeper than what Garg may or may not have done.

Just last week, this column recounted, with horror, how the apex decision-making body for telecom—the Digital Communications Commission (DCC) comprises several top secretaries of the government—took a decision that favoured RJio and hit the incumbents Airtel, Vodafone and Idea for no apparent reason; ironically, one of the three DCC members who opposed the penalty was Subhash Garg. And surely, the decision to reappoint the Trai chief, despite extremely biased functioning, which was commented upon by both the Telecom Dispute Settlement and Appellate Tribunal and the Supreme Court, wasn't Subhash Garg's?

There is a distinct possibility that GDP growth could be in the 6.5% range, so Modi needs to do some really hard thinking since business-as-usual isn't working

It isn't just in telecom, there are too many problems that investors are facing across a host of industries. If the U-turn in the commerce policy after Walmart spent $16 billion to buy Flipkart affected one type of investor directly—others got warned that Indian policy was fickle and can be manipulated by business interests—the decision to impose a common minimum wage across the country will further accentuate the problems of India's rigid labour laws. It is not possible these issues haven't repeatedly been brought to prime minister Narendra Modi's attention as he meets industrialists from time to time; or he can just read the newspapers where these issues are regularly aired. He also has an economic advisory council, PMEAC, and its members—and ex-members—have even gone public with some of their concerns on these very issues. And yet, despite being told that it is not possible to have, in the current global and Indian growth environment, much higher investment levels if India's tax rates are so high, the prime minister didn't think it fit to ensure that the Budget brought down taxes.

Since it is inconceivable that Modi wouldn't have wanted solutions to these issues each time they were brought up, if he is to tackle them properly, he needs a more efficient mechanism to ensure this. One of the similarities between PV Narasimha Rao and Atal Bihari Vajpayee's governments—both were seem as India's most reformist governments—was the presence of an empowered prime minister's office (PMO) that could cut across bureaucratic layers and ensure important decisions were taken quickly.

Modi also needs an economics minister in the PMO, someone with 24x7 access to him to filter out the raft of bad ideas—like demonetisation—a prime minister has to deal with and who can effectively counter the thousands of status-quo ideas that bureaucrats routinely come up with. When it is pointed out that, despite the government repeatedly claiming to have freed up natural gas prices, this applies to just a fourth of current production—the rest gets paid just 40% market price—the bureaucratic answer is that, were gas prices to be raised two-and-a-half times, this would raise prices of electricity as well as fertilisers. In such a situation, a high-profile economics minister, who would be present at all such meetings with the prime minister, would immediately tell the prime minister that raising fertiliser prices was, in fact, in India's best interests. While the poorer farmers could be given a direct cash subsidy to cover the higher fertiliser costs, market-based pricing would stop diversion of fertilisers and also prevent over-consumption; since 60-70% of oil/gas revenues accrue to the government anyway, this can be funded by the government's share in the higher revenues oil/gas firms get. Indeed, if the bureaucracy didn't make a distinction between "marketing" and "pricing" freedom—most people think they are the same—even an ONGC would get $10 more per barrel, a government report tells us; imagine how this would both boost government revenues and also encourage more investment.

There are, literally, hundreds of such issues that come up before the prime minister every day—is a sovereign bond better than relaxing limits for FPI purchases or fully freeing them up as has been done for equity?—and while he can always call upon outside experts for advice, as he did via Niti Aayog two weeks before the Budget, he needs his own Chief Economic Advisor to constantly filter the advice and, more important, once the PM has taken a call, to ensure that the decision is implemented in its fullest sense. Else, we're soon going to run out of Subhash Gargs to blame for the government's dismal economic performance.

DeepIMPACT

International Seabed Authority must strike a fine balance between tech development and marine conservation

THE TECH INDUSTRY'S ever-increasing demand for rare metals, like lithium and molybdenum, portends an explosion in mining of the ocean floor in the coming years. On July 18, the International Union for Conservation of Nature added the scaly-foot snail to its Red List of Threatened Species—the first species to be threatened by deep-sea mining. The marine animal occupies just three locations in the western Indian Ocean; these locations included sites identified for mining. As per *Nature*, countries and corporations already hold contracts for mining exploration of about 1.3 million sq km of the sea bed implying that thousands of marine species, many of which haven't even been identified , face unprecedented extermination and, possibly, extinction risks.

The International Seabed Authority (ISA), responsible for deep-sea mining in international waters, also has a mandate to protect the international sea-bed. Even as it is expected to finalise a code for sea-bed mining by 2020, it must take into account a host of factors that make deep-sea mining almost inimical to the planet's long-term conservation interests—it is feared, deep-sea mining will release vast amounts of carbon trapped in deep-sea sediments, aggravating conditions on the climate change front. Marine scientists have written an open letter to ISA, calling for evaluation of company/country proposals by independent scientists and for the organisation to work more closely with intergovernmental organisations that can forefront conservation concerns in talks with companies, especially since the ISA seems to prioritise its developmental role over its conservation one. But, given how the Earth's future is also tied to tech developments, ISA must strike a fine balance.

RATINGS GAME

IT IS TIME LENDERS TOO MOVE AWAY FROM TOTAL TRUST IN EXTERNAL CREDIT RATINGS, AND START USING EXTERNAL AND INTERNAL RATINGS AS TWO IMPORTANT BUT DIFFERENT LENSES

Implications of hallmarking external credit ratings

ANIL KISHORA
DMD & chief risk officer, State Bank of India
Views are personal

NEITHER MR HENRY Poor nor Mr John Moody or, for that matter, Mr Fitch, whose information gathering and analysis on railroads, canals and other industries in the 19th and early 20th century America laid the foundations of ratings, would have imagined that one day their business of giving out 'opinions' on credit-worthiness would determine how much capital banks need to hold to support their lending. But, now that's a reality. Basel norms mandate banks to maintain a certain ratio of capital to assets, risk weighted as per the ratings assigned by agencies like the ones founded by Messers Poor, Moody and Fitch.

Risk weights were expected to make the capital requirement risk sensitive and perhaps more 'scientific' compared to the rule of thumb, one-size-fits-all Basel-I thresholds. The approach, despite its merits, has its fault-lines; risk weights are based on 'opinions', that too formed by agencies that are paid by the entity being rated and the risk weights themselves are somewhat arbitrary. How do we, for example, know that a AA calls for a 30% risk weight and not 25% or 40%, unless our motto is 'In Basel we trust'.

Given its infirmities, while the system is likely on course to move towards new hybrid approaches combining external ratings and internal models, the reliance on ratings for purposes other than what they were designed for continues to take its toll. The role of ratings in the global financial crisis a decade ago is well known. Nearer home in India, we have recently seen how ratings have migrated from Triple A to D in a matter of months. Ratings are said to be indicators of relative credit worthiness and that curtails their ability to reflect the inherent strength and restricts comparability across countries. Here's a disconnect. Risk weights are uniform globally—a Single A credit in India attracts the same 50% risk weight that a similarly rated credit in Europe would, but the ratings themselves are not comparable.

It is also arguable whether ratings assigned by different agencies even within the same country are comparable. The system of risk weights has commoditised ratings, but the quality or specs of this commodity appear to vary across issuers. Can we standardise ratings? In other words, can we have ratings that are hallmarked? Just the way 22-carat hallmarked jewellery can't have more than 2/24 parts of other than gold content, can the rating institutions be asked to rate with pre-fixed default bands attached to each rating grade?

Sebi's new guidelines are probably a step towards such hallmarking. The Triple Rated cohort of companies is expected to deliver a benchmark default rate of zero over a two year horizon. A tolerance of 1% is permissible when default is measured over a three year period. This elbow room allows for unforeseen circumstances. Progressively, as we move from Triple A to Single A cohorts, the default rate benchmark stays at zero with the horizon getting shorter and the tolerance going up. This is in sync with the fact that the longer the tenor, the riskier it gets. This approach would certainly bring in tighter credit assessment, comparability of ratings across issuers, to an extent, even across countries and, of course, more scrutiny and accountability in light of disclosure requirements put in place.

Sebi's new guidelines are probably a step towards such hallmarking. The Triple Rated cohort of companies is expected to deliver a benchmark default rate of zero over a two year horizon

No change is without implications and consequences. One view is that the new guidelines would moderate ratings and our country would have lesser number of Triple As and Double As. Some Single As might move to that holy band beyond which the junk territory starts. In a way, it helps us align with the jurisdictions which anyway have fewer companies rated at the upper end of the totem pole. USA, the birthplace of ratings, is left with just a few Triple As.

Why this dip in credit quality globally? In a single word, it is the piled-up debt that has dented the ratings landscape. Ballooning debt levels vis-a-vis cash holdings or expected accruals are not sustainable and certainly susceptible to any economic downturns, demand disruptions or liquidity blockages.

As a corollary to changes in rating benchmarks in India, some increase in banks' risk-weighted assets with consequential elevation in capital charge is perhaps a given. In short, more capital requirement. Over a longer time horizon, however, banks should experience lower impairments and better stress test outcomes, with beneficial impact on baseline stress test related capital requirements.

Sebi has done its bit. It is time lenders too move away from total trust in external opinions called ECRs, or External Credit Ratings, and start using external and internal ratings as two important but different lenses, combined with detailed appraisal and assessments to look at credit quality of each and every loan proposal. In a fast growing economy, corporates often tend to not only spread their resources thin, but also latch on to debt-fuelled growth. Like a good tide lifts all boats, a booming economy often assures a pleasant P&L. In times of slow down and sinking demand, it is the strength of the balance sheet that counts for more. Headline credit labels, therefore, despite all the detailed and rigorous data crunching, have their boundaries!

Disputes brewing in GST

Delay in constitution of GST Appellate Tribunal with national, regional, state and area benches has compelled taxpayers to file writ petitions against appellate orders passed by departmental officers

G GOKUL KISHORE
Advocate, Lakshmikumaran & Sridharan
Views are personal

GST HAS COMPLETED two years. GST Council has met 36 times, taken 1,064 decisions (till 34 meetings) and 1,006 decisions have been implemented, according to *GST Concept and Status*. As issues like rate rationalisation and return filing are getting settled, the department has started issuing demand notices in cases of non-payment and short payment of tax or irregular availment of input tax credit (ITC).

Till July this year, orders in 66,067 cases have been passed, involving tax demand of ₹4,199 crore. Taxpayers in 32,630 cases have opted to pay and the amount paid aggregates to ₹502 crore, as per GST Council. The data indicates that roughly half of the cases where orders have been passed are not appealed further and amounts are paid. However, such amounts paid are just one-eighth of the demands confirmed against taxpayers. It seems that taxpayers tend to pay up to give quietus to the proceedings in low value cases while in high value cases, they choose to contest by filing appeals. An amount of ₹4,199 crore in disputes is modest and does not ring any alarm. But, the fact that issue of demand notices has not yet become a routine affair and audit process is yet to commence indicates that such numbers are bound to explode. A look at the position adopted by the department before Authority for Advance Rulings (AAR) reveal that several issues are contentious, and the department is likely to litigate.

As many as 80,613 instances of voluntary payment of tax, involving ₹1,18,526 crore, have been recorded. Department has issued e-acknowledgement to such payees in 488 cases and has issued necessary order on conclusion of proceedings in 83 cases. The amount of voluntary payment is higher due to a host of reasons. Voluntary payments arise when the taxpayer notices defects like short payment of tax, payment of incorrect type of tax (IGST instead of CGST and SGST and vice versa), wrong availment of ITC and availment of ineligible refund. The amount paid through this method is more than 5% of the total GST collections of ₹19.17 lakh crore since July 2017.

The very low number of issue of acknowledgement by department accepting voluntary payments can be attributed to two reasons. First, the relevant Rule 142 of CGST Rules refers to payment of tax by taxpayers on their own before issue of demand notices. Payments made in other cases are not covered by Rule 142(3) for such e-acknowledgement and acceptance by the department. Second reason could be the fact that functionalities like e-acknowledgement through GST portal became operational much later. This essentially calls for both amendments to rules to provide for e-acknowledgement in all cases of voluntary payments (not restricting to only cases of demand notices) and also to close the gap in making functionalities fully operational.

As against 4,90,094 applications filed for refund of tax amount of ₹89,108 crore, the department has processed 52,172 claims involving amount of ₹13,618 crore

As against 4,90,094 applications filed for refund of tax amount of ₹89,108 crore, the department has processed 52,172 claims involving an amount of ₹13,618 crore. Export refunds are not included in this data as they are processed automatically, based on shipping bill itself, without a separate claim. While time limit for filing refund claim is two years for the taxpayer, the department is required to issue refund order within 60 days from receipt of complete application. The department may seek more documents and the time-limit can get extended leaving the same to the discretion of the tax administration. The data shows that around one-tenth of the refund claims have been processed. Considerable delay on the part of the department in processing claims despite statutory time-limit has led to huge backlog of claims. The refund amount sanctioned so far presents a better picture vis-à-vis the amounts claimed. One reason could be high value refunds are diligently pursued by claimants to ensure that the application is complete in all respects leaving no room for objections by sanctioning authorities.

Demands tend to rise when the department and taxpayer are not able to agree on interpretation of a statutory provision and consequently the practice adopted. Advance ruling mechanism in GST law has been provided to resolve issues at the initial stage of business or before they become full-blown disputes. This facility is available not only for proposed activities but also for current business activities. But, the AAR has remained less attractive. The bodies were set up little late, after implementation of GST. Almost all the states have constituted these bodies. In around 18 months' time, 976 applications for advance rulings have been filed (till May 2019) in all the states put together. In most of the North Eastern states, Assam and J&K, no application has been filed so far. The figures indicate that just about one tenth of applicants use Appellate Authority for Advance Rulings (AAAR). It is a fact that AAR is manned by bureaucrats and most of the rulings have not been in favour of the taxpayers. Appellate AAR is also a body comprising members drawn from tax administration. The perceived revenue bias of these bodies has a deterrent effect on the taxpayers.

Delay in constitution of GST Appellate Tribunal with national, regional, state and area benches has compelled taxpayers to file writ petitions against appellate orders passed by departmental officers. With two technical members drawn from tax administration and only one from the judiciary, the provisions relating to tribunal are under challenge in various High Courts. While notification has been issued for establishment of such tribunal, the same is also sub-judice. GST Council should frame a comprehensive litigation policy under GST before issues spiral out of control.

LETTERS TO THE EDITOR

Unnao rape victim accident

It was sad that the Unnao rape survivor was 'critically injured' when a truck hit the car in which she was travelling. It is still not clear whether she is battling for life or is now out of danger. The disfigurement of the number plate of the truck involved in the head-on collision and the withdrawal of the police personnel despite the court order to provide security cover to the young woman and her family round the clock raise the suspicion that it could have been premeditated attempt to murder the rape victim. The kin of the rape victim allege that it was purely the handiwork of BJP MLA Kuldeep Sengar. 'Car crash' is a common and time-tested method used to finish off inconvenient people. The rape accused has a lot clout with the state government, something that explains the ill-disguised collusion between the police and the perpetrators of the crime of attempted murder. The contention by the cops that the crash happened during heavy rains was a feeble attempt to establish that it was just a road mishap and an indication of how the investigation would proceed. Notwithstanding its zero tolerance for violence against women, BJP is extremely protective of one of their number accused of rape. It was possible that the teenage rape survivor's attempted self-immolation in front of the house of Chief Minster Yogi Adityanath incensed the ruling dispensation and provoked it to take revenge on her. If those who seek justice are weak and vulnerable, they are targeted in ruthless ways. Remember the death of the victim's father in police custody obviously due to torture. The latest incident smelling of conspiracy and foul play is one more example of lawlessness in Uttar Pradesh belying the claim of "Ram Rajya". We urge the Supreme Court, the protector of the right to life, to take *suo motu* cognisance of the incident, monitor the CBI probe and see to it that the culprits, however powerful or influential they are, do not go unpunished.

— G David Milton, Maruthancode

●Write to us at feletters@expressindia.com

Regd. No: DL-21048/03-05. R.N.I. No.26750/74. Printed and Published by R.C. Malhotra on behalf of The Indian Express (P) Limited and printed at The Indian Express (P) Limited Press, A-8, Sector-7, Noida - 201301 and published at The Indian Express (P) Limited, Mezzanine Floor, Express Building, 9 & 10, Bahadur Shah Zafar Marg, New Delhi-110002. Phone: 0120-6651500, Fax: 0120-4367933. (Cover price: Patna: Mon-Fri ₹6, Sat ₹9, Sun ₹11; Raipur: Mon-Fri ₹7, Sat ₹10, Sun ₹10)
Chairman of the Board: Viveck Goenka, Managing Editor: Sunil Jain, Deputy Managing Editor : Shobhana Subramanian* (*Responsible for selection of News under the PRB Act)


ILLUSTRATION: ROHNIT PHORE

RENU KOHLI

The author is a New Delhi-based macroeconomist

FOREIGN CURRENCY SOVEREIGN BONDS

Think before you leap?

It's time to revisit the recommendations of Tarapore Committee reports on capital account convertibility

THE DECISION TO borrow in foreign currency abroad to finance part of government's fiscal deficit has opened a Pandora's box. It excited markets, causing the benchmark bond yield to fall sharply with beneficial impact on funding costs. But many economists, including former RBI Governors and Deputy Governors, have raised red flags, possibly compelling the government into second thoughts. This was one of those odd issues where the markets and economists were at loggerheads; the latter in particular displaying their deep distrust about the former. Former RBI Governor Raghuram Rajan was particularly critical of market participants and its advocate foreign bankers (*Times of India*, July 13, 2019; *http://bit.ly/2Yrtz3P*).

Why is sovereign foreign currency borrowing such a folly? The fine distinction between two different capital account measures bears significance: While FPIs bear the exchange rate risk in rupee-denominated sovereign debt, it devolves upon the sovereign when foreign currency-denominated. The latter is viewed through a narrow prism of the 'original sin' (i.e. emerging market economies are forced to borrow in foreign currency because they are unable to issue local-currency debt abroad) especially for countries experiencing periodic turmoil in their external accounts. YV Reddy, former RBI Governor (*Business Standard*, July 18, 2019; *http://bit.ly/2LMFrHE*) flagged other key risks and complications involving sovereign debt, concurring with Dr Rajan that all addictions start small. Bimal Jalan, former RBI Governor, has been the rare exception to downplay such risks and support sovereign borrowing given India's current economic fundamentals.

The question before policymakers is not if India can borrow in foreign currency on current fundamentals? Rather it is if it should do so given the associated long-term risks. Dr Reddy has wisely advocated outlining a roadmap towards capital account convertibility wherein sovereign bonds are back-loaded, not upfront.

The unfortunate part of this 'for-and-against' debate so far is that no one has explained where do the several and carefully articulated recommendations of the Tarapore Committees, 1997 and 2006 (TC-1, TC-2 hereafter) on capital account convertibility stand; these have been long-standing edicts for determining pace and sequencing. Here we revisit some key fiscal preconditions regarded paramount to ensure a strong sovereign balance sheet before venturing in to this unchartered territory!

Fiscal preconditions: What TC-1 and TC-2 recommended

An accepted element of risk exposure is the strength and quality of the balance sheet. This requires stock-taking to be monitored. TC-1 outlined fiscal preconditions/signposts for gradual entrenchment to liberalise the capital account for three years to March 2000; actual fiscal outcomes were to determine the pace. TC-2 (2006) reviewed progress after then Prime Minister Manmohan Singh's request "...to revisit the subject and come out with a roadmap based on current realities" in a speech at RBI in March 2006. Each aspect—India's experience till then; implications for monetary and exchange rate management, financial markets and financial system, dollarisation of domestic assets and rupee internationalisation, the regulatory framework in other countries that advanced similarly—was to be studied for providing "*...a comprehensive medium-term operational framework, with sequencing and timing, for fuller capital account convertibility taking into account the above implications and progress in revenue and fiscal deficit of both Centre and states.*" The last is what Dr Reddy has in mind.

TC-2 noted fiscal consolidation, viz. Centre's gross fiscal deficit and domestic liabilities (shares of GDP), fell short of TC-1's expectations. The recommended concomitant preconditions were, *inter alia*, the Centre's fiscal deficit reduction to 3% of GDP, elimination of revenue deficit by March 31, 2008, and building a revenue surplus (1% of GDP) by 2010-11. Revenue surplus was the key first step for repayment of marketable debt, explicit and implicit. TC-2 urged focus upon gross, not net market borrowings as the former related to market's absorptive capacity and to gauge potential borrowing costs. And for more accurate assessment of the fisc's resource dependence on the economy, TC-2 advocated graduating to a public sector borrowing requirement (PSBR) measure instead of the fiscal deficit. PSBR was roughly assessed as 3% of GDP above the fiscal deficit in 2006. TC-2 suggested RBI attempt a preliminary PSBR assessment and make it public to facilitate its adoption as a clearer indicator of the public sector deficit.

Fiscal position: TC-2's preconditions (2006) and now

How does the current picture compare with TC-2's preconditions? The accompanying table identifies the salient shifts, including absence of PSBR's relevance from the revised fiscal framework (2018). Three features make TC-2's position on PSBR very relevant in the current context.

One, PSBR remains near about 3% of GDP higher than the fiscal deficit. For FY17, the CAG estimates off-budget/extra-budgetary borrowings aggregated 2.85% of GDP. It reportedly recalculated the fiscal deficit including extra-budgetary resources for the 15th Finance Commission for FY18, placing it at 5.85% against 3.46% of GDP reported in the budget!

Two, the government openly acknowledged it was compelled to borrow abroad to spare domestic resources for the private sector. No better proof that PSBR matters for crowding-out, pressures real interest rates as impressed by TC-2 back in 2006.

Three, the repayment issue follows directly from falling tax revenues and constant increase in total public borrowings. A vicious cycle of higher market borrowings follows higher repayments, contributing to the debt burden (see chart). Gross interest payments reached 37.3% of revenue receipts in FY19—7.6 percentage points higher than 2010-11 levels! The Centre's debt-to-GDP ratio is indeed lower than 2006 levels, but stagnates around 48-49% after 2010-11. TC-2 emphasised repayment obligations financed through gross borrowings do not affect the gross fiscal deficit for any particular year, but the associated interest burden still fuels subsequent revenue and gross fiscal deficits.

This assumes current relevance because key fiscal indicators do not display sustained, trend improvement; meaningful fiscal consolidation has not happened. Windfall oil revenues (Rs 2.73 trillion) and voluntary disclosure schemes brought about betterment in FY17. The revenue deficit has risen thereafter; primary deficit stagnates. Gross tax revenues dropped to 9.9% of GDP last year!

The FRBM (2018) anchored the medium-term fiscal strategy upon the debt-to-GDP ratio, making fiscal deficit the operational target. The absence of revenue deficit target means no bar on the shift towards revenue expenditure which would balloon. The focus on fiscal deficit to achieve debt-GDP targets induces government to move capital expenditure outside the budget. The worst part is of revenue expenditure being pushed out.

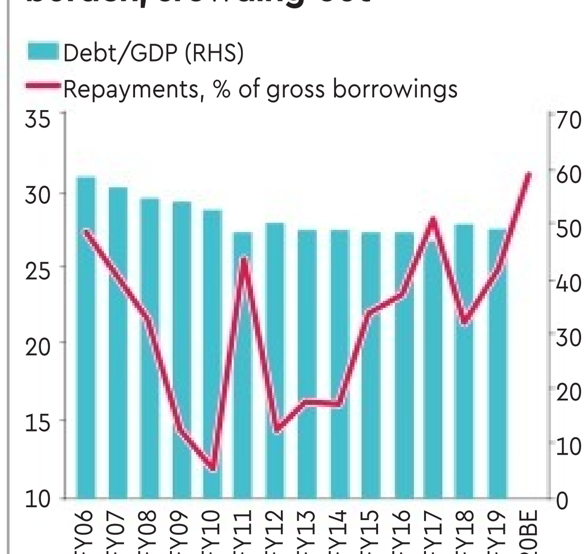
The literature on 'original sin' is straightforward: countries without solid fiscal and financial sectors should avoid borrowing in foreign currency. TC-1 and TC-2 had primarily focused on this, emphasising the adverse effects of fiscal weaknesses are transmitted much faster with increased capital account openness; as sound fiscal position that moderates PSBR was essential therefore. In the present liberalisation, the government is pretty much admitting to paucity of domestic resources. There's a view that borrowing $10 billion will not be a stress given high forex reserves. But what we are actually witnessing is a situation of domestic resource constraints that could worsen in the years ahead.

The question is if the signposts and risk concerns expressed by the Tarapore Committees are no longer valid and why? One needs to revisit these issues. An in-depth, all-round assessment of the strength of India's macroeconomic framework, with recourse/reference to past committees that included experts and practitioners and carved out in stone, as it were, critical preconditions, is necessary. Perhaps RBI, which surely realises implications for future macroeconomic management and financial stability policies, can conduct this.

Tarapore Committee on Fuller Capital Account Convertibility, 2006

Concomitants	Current status
Central government to build a revenue surplus of 1.0% of GDP by 2010-11.	Revenue account continued to be in deficit; at 2.34% of GDP in 2018-19.
A substantial part of the revenue surplus of the central government to be earmarked for meeting the repayment liability under borrowing programme, thereby reducing the gross borrowing requirement.	Centre has failed to generate revenue surplus since its proposal in 2006. The NK Singh led FRBM Review Committee 2017 did not advocate a radical approach; it favoured gradual reduction in revenue deficit to 0.8% of GDP by 2022-23. Amended FRBM Act 2018 did away with setting any revenue deficit target.
As part of better fiscal management, the Central government and the States should graduate from the present system of computing the fiscal deficit to a measure of the Public Sector Borrowing Requirement.	The NK Singh FRBM Review Committee 2017 did not recommend any thing on PSBR (discussing off-budget borrowings only in respect of states: para 3.5, pg 90); accordingly, amended FRBM Act 2018 is silent on this.
RBI should attempt a preliminary assessment of PSBR and put it in the public domain, which would then facilitate the adoption of PSBR as a clearer indicator of public sector deficit.	RBI has not expressed its views on PSBR assessment. It is only recently that the CAG office has attempted estimation of central government's PSBR and urged the government to maintain better transparency by bringing those into the budget (Report no 20, 2018).
The Office of Public Debt should be set up to function independently outside RBI.	The government's move to set up an independent Public Debt Management Agency (PDMA) has been facing stiff resistance from RBI

Sustained rise in repayments from borrowings contribute to debt burden, crowding-out



Source: RBI handbook, Debt-GDP for FY18, FY19 from budgets FY19, FY20, with author's calculations

BIT BY BIT

5G in the times of call drops

NANDAGOPAL RAJAN

nandagopal.rajan@indianexpress.com

Next-gen telecom tech is almost here, but consumers need basic issues redressed

I DREAD EVERY TIME I pick up the phone to make a call. There is no guarantee I'll be able to connect. If I connect, I usually ask: 'Can you hear me?' Most voice calls end up in failures, gradually making WhatsApp calls the new normal. So it is natural the imminent launch of a new technology like 5G will offer some hope to 'voice-less' telecom users. It is also ironical that when some parts of the world are rolling out the latest generation of telecom networks that can stream an interactive 8K video in 3D, we are struggling to make a regular voice call that many would think is the basic requirement of a telephone network.

But then how easy will the shift to 5G networks be? In a recent conversation, Nitin Bansal, head of Ericsson India, and head of Network Solutions Ericsson South East Asia, Oceania & India, told me that at least for his company switching on 5G services will be as easy as activating the service in areas where network operators are using its latest radios. But then 5G will be only as good, or bad, as 4G without the bandwidth. "Our fight is also about getting better speed, which comes with bandwidth. Now, that's where 3.5GHz and 28GHz play a key role, because our recommendation is at least 100MHz to see the value of the higher data," explained Bansal. There will be improvements. "Activating 5G on the existing radios, you get speeds similar, maybe a few per cent better than 4G, and you will get the advantage of lower latency," he said.

Ericsson's studies project the data traffic per smartphone per month, which is already the highest in India at 9.8GB, to double by 2024, as total subscriptions reach 1.1 billion. But it won't all be 5G-driven. By 2024, LTE is expected to account for 82% of all mobile subscriptions in India, compared to 38% in 2018, and 5G will account for just 6% of total subscriptions. So don't expect the pain points to go away; there might be some new ones too for the early movers.

> People expect extended battery life and extreme inbuilt storage to be standard for 5G devices, but first let's see if 5G will let us make a drop-free voice call

But there will be a huge impact on the economy as a whole, with the increased data speeds offering new opportunities and use cases, some of which we might not even know currently. Rohan Agarwal, director of Micromax, who is tasked with expanding the company's footprint in the consumer electronics space, is looking forward to 5G to push India's television consumers to the next level. "Customers now prefer OTT applications like Netflix and Amazon Prime, as viewing patterns have changed over time, from cable to digital satellite to now video on-demand," Agarwal said, explaining why the company will start exiting from non-smart TVs above 32 inches. So even at the base level, companies are expecting a shift towards smarter, data-driven TVs. And since fibre is still not ubiquitous in a country like India, taking high-speed data to homes might rest on the shoulders of 5G.

At the top end of the pile, companies like Samsung are already selling 8K QLED smart TVs as Japan prepares to offer 8K streaming of the Tokyo Olympics next year. However, that is not something 4G networks can handle.

"For me, an important use-case for India is fulfilling the need of subscribers to get high-speed internet connectivity at home. When it comes to industry, there is a lot of work going on in B2B. Then again, it is also country-specific... you are trying to solve something that can be improved in a certain country or a city or a specific application," explained Bansal. Ericsson's studies have shown that Indian smartphone users are willing to pay more than 66% premium for 5G services like 5G TV, VR Cloud Gaming, 5G in-car entertainment, and Virtual Tactile Shopping. Interestingly, consumers' expectations from 5G are based a lot on their current struggles. Most expect extended battery life and extreme inbuilt storage to be standard for 5G devices, the first of which have already been announced this year.

While 5G is expected to ease the 4G congestion and make connectivity there better, it will also open up new areas of revenue. "One is the normal enhanced mobile broadband kind of applications... so more subscribers, more usage, more revenue. The other one is on non-consumer use-cases, in more B2B kind of use-cases," he said, adding that 5G will open up additional revenues of about $27 billion by 2027, of which approximately $13 billion will go through operators. But first let's see if 5G will let us make a drop-free voice call.

INDIA EQUITY MARKETS

A quick end to the hope trade

Nifty is down 6% over 15 days; despite the narrative of slowdown, India is effectively giving up out-performance over emerging markets earned post elections

MSCI INDIA/NIFTY have fallen about 6% over 15 days. The narrative of a slowing economy, poor earnings and a simmering NBFC crisis is front and centre. Yet we think the Indian market is simply giving up the out-performance (over emerging markets) it earned in May, upon the publication of the exit polls (chart 1). The Budget in early July, which was devoid of any major 'stimulus', seems to have catalysed the reversal. This is largely over. Should Indian under-performance continue beyond? Growth is slowing, but so is it elsewhere.

With little happening locally, headline Indian indices are now likely to move with emerging market trends. US Fed action/commentary, US-China trade wars and dollar outcomes are likely to dominate market direction in the near term.

Bottom-up ideas though likely will remain scarce: (a) Earnings beats/upgrades are rare now, (b) valuations are still elevated. Mid-cap premiums to large caps have fallen, but absolute multiples are still high (chart 2). We see little upside to markets through the year (Nifty December at 11,300) and stay overweight financials, IT and industrials.

The index is misleading, but index stocks will dominate: Notwithstanding the current sense of despair, the Nifty is still up about 5% YTD (in dollars). Total market cap of the top-20 stocks (by current Nifty weight) is up 14% from end-December 2017 levels. Market cap of all Indian stocks outside these 20 is, however, down 27% over the same period (chart 3). Almost 40% of BSE500 ex-financials are now below their January 2017 prices. More than half are now below January 2017 forward P/E. Yet it is not that the broader market has become cheap in total: trailing P/E of the top-1,000 stocks (excluding the top-20, chart 4) is still well above January 2016 levels. Nifty weights have played a part as well: the unweighted change in Nifty market cap is less exciting than the weighted change YTD (charts 5, 6). There are two reasons to call a bottom: (a) valuations: this argument cannot still be made for Indian stocks in general, or (b) a recovery in earnings: weak at the moment (though this is where there is room for surprise). Until growth and earnings recover, large cap index stocks can continue to outperform.

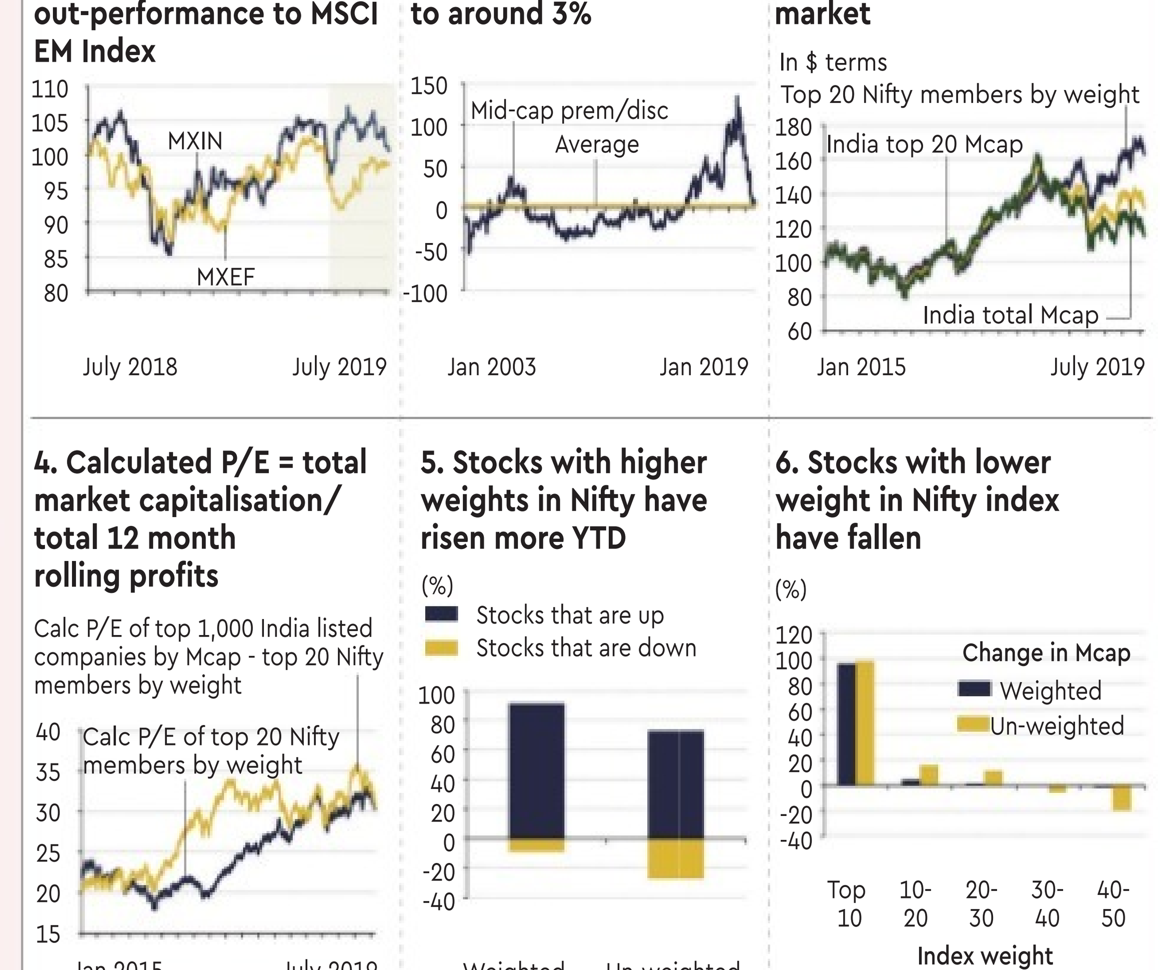
Auto sales

Are auto sales weak because the economy is slowing, or is GDP growth down because auto sales are weak?

A good question to ask, but difficult to answer. We estimate about 44% of the deceleration in GDP growth between December 2018 and December 2017 was on account of weaker industry. On first order impact, weaker autos account for about 30% of the moderation in IIP. Yet there are second order effects as well: volumes for tyres, industrial paints, batteries have all fallen recently. We have argued earlier that the weakness in Indian demand is idiosyncratic, a reversal may not consequently be contingent on government policy redemption; trends could auto-reverse with time, and as interest rates fall. Auto components will become favourable in 3Q/4QFY20; headline numbers will appear better. Autos have significant potential for rotation, having underperformed for an extended period, followed by metals, healthcare and staples. Rotation becomes important in a market without a rising tide. Sectors where momentum has started recently are construction, telecom and non-banking financials. And sectors that have lost momentum recently include energy.

(*Excerpted from BofAML Equity Strategy report* 'India: A quick end to the hope trade. EM, earnings now matter most' *dated July 25, 2019*)

1. MSCI India has lost most of its post-election out-performance to MSCI EM Index
2. Mid-cap P/E premium to large-cap has eroded to around 3%
3. Large cap stocks have out-performed the broader market
4. Calculated P/E = total market capitalisation/ total 12 month rolling profits
5. Stocks with higher weights in Nifty have risen more YTD
6. Stocks with lower weight in Nifty index have fallen



Source: BofA Merrill Lynch Global Research, NSE India, Bloomberg