Opinion

THURSDAY, OCTOBER 3, 2019

SMELLS LIKE A COUP

President of the US, Donald Trump

As I learn more and more each day, I am coming to the conclusion that what is taking place is not an impeachment, it is a COUP

GST outlook worrying, big expenditure cut likely

Direct taxes below target and with GST shortfall, overall taxes could fall short by ₹2 trn; state compensation dicey

WITH GST COLLECTIONS by the central and state governments (CGST + IGST + Compensation Cess + State GST) coming in at just ₹91,916 crore, or the lowest in the last 19 months, not only are the central government's overall tax numbers in trouble—more so after the corporate tax rate cut—even the GST compensation to state governments could be affected. According to Credit Suisse, while there could be a ₹210,000 crore overall shortfall in all central tax collections now, the fall in GST means state revenues from this tax will also come under pressure. In which case, as per the agreement with them, the Centre, which had promised to ensure their GST revenues grew at 14%, will have to give them more compensation. According to Credit Suisse, the compensation that was budgeted to be around ₹109,000 crore in FY20 could rise to ₹150,000 crore; based on April-August data from the Controller General of Accounts (CGA), the compensation cess collections are averaging around ₹7,900 crore per month right now. In which case, the central government will have to dip into its own tax collections to compensate the states. While the Centre is keen to revise this pact with states—valid till FY22—the state governments are trying to ensure that it extends a similar guarantee for another five years after FY22.

West Bengal finance minister Amit Mitra has been arguing that if GST collections continue to fare as they are right now, state government collections will continue to be under pressure. The crux of the problem is that, with the government—the Centre and states—not able to bring in the invoice-matching feature that is key to raising compliance in the GST system, the required buoyancy in GST collections is far from what is required. GST collections by the central government (CGST + IGST+ Compensation Cess) in FY19 were ₹582,000 crore, a figure that was short of the original target of ₹743,000 crore; this was later revised down to ₹643,000 crore. While the government had budgeted a growth of around 13% in FY20—a monthly run-rate of ₹55,278 crore versus ₹48,500 crore in FY19, the April-August FY20 run rate was just ₹47,321 crore. And, as compared to the same period in FY19, there has been virtually no growth at all.

Faced with a big tax shortfall, the government will then have no option but to either raise the target from divestment of existing shares of PSUs—including the SUUTI shares it owns—as well as aggressive privatisation of these firms. While the budget has estimated receipts of ₹105,000 crore under this head—as compared to ₹80,000 crore in FY19—it is not clear that an amount larger than this can be raised if the stock markets don't remain buoyant; also, if there are too many equity offerings, the appetite for them might reduce. The other option is to make aggressive cuts in expenditure. What is more likely is a combination of expenditure cuts and more divestment/privatisation, along with the usual rollover of certain expenditure on subsidies like those on food and an increase in the fiscal deficit; the likely slower nominal GDP growth, in any case, will add to the fiscal slippage.

An atrocity, indeed

SC recalls checks on Atrocities Act misuse

THE SUPREME COURT (SC) recalling its March 20, 2018, order that put checks on the misuse of the Scheduled Castes and Scheduled Tribes (Prevention of Atrocities) Act is quite unfortunate. A bench comprising Justices AK Goel (now retired) and UU Lalit had diluted some of the more draconian provisions of the Atrocities Act—relating to arrest of the accused and the granting of bail—to discourage the use of the Act as a tool to "blackmail" innocent citizens and public servants. The bench had felt that the law was being used for exacting "vengeance" and realising vested interests, and stated that instead of helping erase caste divides, it was reinforcing these and was even helping "perpetuate casteism". So, while the Act originally provided for immediate arrest of the accused followed by judicial remand and barred anticipatory bail, the SC ruled that arresting public servants accused of an offence(s) under the Act will require written permission from their appointing authority, and, in the case of private citizens, permission from the senior superintendent of police will be required. It also scrapped the provision barring anticipatory bail, a statutory right.

Now, a three-judge bench comprising Justices Arun Mishra, MR Shah, and BR Gavai, has recalled the 2018 judgement, saying that if it were to be implemented as worded, then "the very purpose of the Act is likely to be frustrated." Indeed, while the 2018 order called for an investigation before arrests were made, the SC, in the latest judgement, notes, "Various complications may arise. Investigation cannot be completed within specified time…delay would be adding to the further plight of the downtrodden class." While the fact that a charge-sheet was filed in over 78% of the Atrocities Act cases the police took up for investigation in 2016 and disposed would suggest that there is a prima facie case for keeping the original provisions, the courts awarded convictions in just a fourth of the cases that went to trial that year. Poor convictions also have a lot to do with weak prosecution or witnesses being coerced, it is true, but that holds for all crimes and not just those under the Atrocities Act. In its recall judgement, the SC said that the permission criterion laid down by the March 2018 judgement "is not at all statutorily envisaged; it is encroaching on a field which is reserved for the Legislature. The direction amounts to a mandate having legislative colour which is a field not earmarked for the Courts." It also said that the March 2018 judgement was "against the concept of protective discrimination in favour of the down-trodden classes." It should have kept in mind that the judgement—rendered nullified with Parliament later passing a law to restore the original provisions on arrest and granting of bail—in no way impinged on scheduled caste/scheduled tribe individuals getting justice in genuine Atrocities Act cases; it only provided for protection against wrongful application of the law.

Ringing INDICTMENT

Trai's failure to act in a timely manner has stoked the needless ringing-time jousting amongst telecom players

WHILE TRAI WAS notified of RJio reducing its ringing time to 20 seconds some months ago, its failure to take cognisance of this and initiate action has now pushed other telcos to do the same. Jio subsequently raised the ringing time to 25 seconds, but older networks allowed for a 45-second ringing time. Now, both Airtel and Vodafone have decided to bring down ringing times. So, a person that receives a call gets only 25 seconds to respond. While Trai did release a consultation paper on the matter, it failed to ask telecom service providers to stick to the legacy ring-time before a final ring-time was fixed.

This is not the first time that Trai's inaction has had such implications for stakeholders in the telecom space. It has even been accused of bias by TDSAT and the Supreme Court, and rapped by the Telecom Commission, telecom's highest policy-making body. More important, in this matter, the issue is not of ringing time, but of the interconnect usage charge (IUC)—this is what the originating network pays to the terminating network. But, when the ringing time is shortened, and there are more missed calls, those who received these calls are likely to return them; a telco that would have paid an IUC now ends up collecting it. When Trai reduced the IUC rates in 2017, to six paise from 14 earlier, this wasn't without its share of controversy either. New players, like Jio, that use IP technology wanted IUC eliminated, and argued that IUCs created a barrier to entry for new operators—the IUC meant Jio's IUC payments exceeded what it charged customers—and was the reason for legacy operators not upgrading themselves. On the other hand, legacy players that had already built sizeable networks on the older technologies batted for higher IUCs. Ideally, instead of a Trai-mandated IUC, this should have been a market-determined one, with negotiations between the major players; all that Trai needed to mandate was that interconnections couldn't be refused or delayed.

POPULATION WOES

WITH THE 18-23 POPULATION HARDLY GROWING, INDIA WILL SOON HAVE AN AGEING POPULATION SUPPORTED BY A SHRINKING WORKFORCE

Need urgent action to reap demographic dividend

TV MOHANDAS PAI & NISHA HOLLA

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INDIA IS ON a formidable growth trajectory since liberalisation in 1991. In nominal terms, the economy has grown from $275 billion in 1991 to $2.7 trillion in 2019, at a CAGR of 8.5%. In the short term, there is an urgent need to fix the liquidity crisis that has caused an economic slowdown. In the long term—having taken care of most basic necessities—India is undoubtedly in nation-building mode. Understanding how our demographics are changing is more important than ever to plan this.

Over the last twenty years, India has achieved ~100% enrollment in primary school. The accompanying graphic shows the number of children enrolled, and Gross Enrollment Ratios (GER) in primary school. GER is the ratio of children enrolled in a particular class to the eligible population in the age group for that class (ages 6-10, for primary school). The prominent rise of mid-day meal schemes since 2000 has contributed towards higher enrollment.

GER can go over 100, as it has most years since 2001, when children outside ages 6-10 enroll in primary school. 100+ GERs indicate that many older students, who probably missed out on the opportunity to study at that age, are joining school to get an education now. 100+ GERs could also indicate some students are failing to move into secondary school, and are being held back. GER rose up to 115.5 at peak in 2010-11, indicating 15.5% more children enrolled apart from those in the age bracket of 6-10 across India. It has since reduced to ~100.

With ~100% enrollment achieved, it is interesting to note that the number of children enrolled in primary school peaked at 13.98 crore in 2011-12, and has since steadily decreased to 12.91 crore in 2015-16. This decline corroborates census data that the percentage of children in the population has reduced from 18% in 1991 to 13% in 2011, and may decline to 11% in 2021, as analysed in our previous article (*bit.ly/2krwGa2*).

MHRD data indicates that of the 100 children entering Class 1, ~80 move onto Class 10, where ~79% pass, and 56 enter Class 12, where ~78% pass the state and central boards. Indications from MHRD's large database tracking 13 crore children are at odds with surveys by NGOs like Pratham that use thin surveys of 5.5 lakh rural students to suggest that, for example, only 27% of children in Class 8 can read Class 2-appropriate texts. Policymakers must use MHRD's massive database that has comprehensive examination performance data to understand quality of students—both urban and rural.

After Class 12, the number of youngsters entering higher education drops further—AISHE data indicates GER in 2018-19 was 26.3 across India. AISHE also uses the information from its surveys to estimate the population in the ages of 18-23, the eligible ages for higher education. The accompanying graphic indicates this number has hardly grown from 14.03 crore in 2011 to 14.2 crore in 2018, translating to a CAGR of only 0.18%. Low CAGR in this age group is a clear indication that our workforce size will stagnate soon.

With the number of children in India reducing, and the 18-23 population hardly growing, soon India may have an ageing population supported by a shrinking workforce. Today, however, we have an incredible advantage—we are the youngest of the large economies. Median age here is 28 years, compared to 32 in Brazil, 37 in China, 38 in the US, 40 in the UK, and 47 in Japan. Having such a large young population is an irreplaceable opportunity India must take advantage of before it is too late.

■ **Robust educational pipeline**: Now that the first step of 100% enrollment in primary school is complete, focus must shift to keeping our children in school, and providing a quality education. Emphasis is needed in districts with low scholastic achievement. Today's school students are tomorrow's workforce.

■ **Staffing for schools:** A substantial part of the Union budget supports teacher training and staffing in schools. With the number of children in decline, we must understand when it will taper, and plan staffing accordingly. Care must be taken to not over-budget and build excess capacity here.

■ **Improve higher education:** India's higher education base lags in both enrollment and quality. AISHE 2018-19 indicates there are 51,649 institutions in India. For an eligible population of 14.2 crore, that amounts to ~2,750 students per institution. So, we have the base infrastructure required; we may need 10,000 more institutions over time, but the focus now should be on enhancing our current institutions, improving enrollment, and imparting quality education. A study by FICCI suggests GER can grow to 50 by 2030. Overall quality-wise, India's institutions aren't keeping up with US and Chinese institutions—this year, for the first time in seven years, no Indian institute featured in the Times Higher Education World University Rankings. We lag in research and impact, international outlook, and industry outcomes.

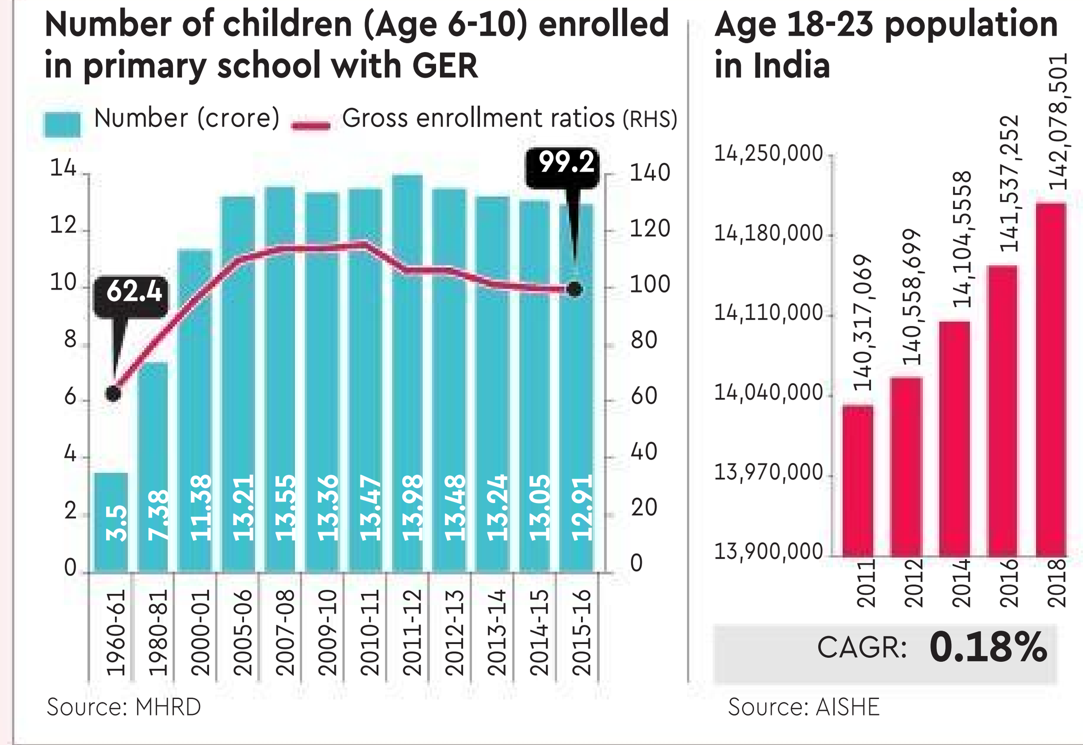
■ **Build expertise in specialised industries with high value-add:** Dominating some industries with high value-add compounds returns over time. The Indian IT industry has already demonstrated this—it employs over 4.5 million highly skilled people, clocked $137 billion in exports last year, and has a high value-add of 70.6% (per MOSPI CSO). There is an urgent need to identify industries with high value-add and build pipelines—right from colleges to research laboratories and deployment infrastructure. Other examples are financial services, hardware and chip design, automobile and EV design, defence equipment, new manufacturing paradigms in product design and 3D printing, pharmaceuticals, biotechnology, and chemicals.

■ **Improve labour force participation:** Our previous article (*bit.ly/2GAaSk6*) compared EPFO employment data with number of graduates in each state to demonstrate that most states have very low coverage ratios. Only Maharashtra, Karnataka and Gujarat are producing more formal jobs than graduates. India's coverage ratio is barely over 50%. There is urgent need to provide mass employment as well as opportunities for highly skilled workers.

■ **Ensure participation of women:** With a forecast of a gradually shrinking workforce, India needs to ensure participation of women to reap the demographic dividend. As discussed in our previous article (*bit.ly/2WSFKWq*), women's enrollment in higher education is on the rise, and may overtake men's enrollment soon. There is urgent need to carry forward this advantage into the workforce.

■ **Improve alternative labour force training modes like vocational and skills training:** Higher education is not the only workforce training mode. South Korea, Japan, and Germany have built robust industries, like electronics manufacturing and automobile design, with a highly skilled workforce trained through vocational programs. Meanwhile, China is a great case study in imparting skills to a large population, and providing mass employment in labour-intensive industries. India must study these paradigms and deploy the same to build a robust workforce that can be converted into a massive economic and export trade advantage.

With these policies, our young population can be assimilated into a skilled, diverse and specialised workforce, on the backbone of which, India can become a top-three economy next decade. This is required urgently to meet PM Modi's ambitious vision of $5 trillion by 2025.



Europe has a way out of tariffs

Analysts of trade wars take into account lots of data on how demand in various sectors reacts. However, they ignore a potentially meaningful factor: the "brand value" of the country of origin

LEONID BERSHIDSKY

Bloomberg

THE TRADE WAR between the US and China has already slowed down growth in Europe's export-oriented economies—including the biggest of them, Germany—even though they haven't been slapped by any punitive tariffs. The wholesale buyers of European products, though, should perhaps be more optimistic about signing deals: Consumers attach a lot of value to the national brands of Germany, Italy and France, and that may compensate for any price increases caused by tariffs.

So far, the US president Donald Trump's trade wars have largely spared Europe, and German exports haven't seen a significant drop.

But Germany's economy has stopped growing, in part because trading partners' concerns about future tariff hikes are already leading to lower factory orders. On the face of it, the worries are justified: Analytics abound that predict big hits to demand if the trade war spreads to Europe.

The models used to predict the impact of trade wars take into account lots of data on how demand in various sectors reacts to price changes. They largely ignore, however, a potentially meaningful factor: the "brand value" of the country of origin.

There is surprisingly little research on how consumers' perceptions of a product's country of origin affect their willingness to pay. The little academic work that exists on the subject shows consumers are likely to pay more for the same product if it comes from a country they think is good at making such products. And when it comes to such perceptions, Western European countries shine.

A survey published this week by the polling firm YouGov and the Cambridge Globalism Project shows that, across 23 countries where the study was carried out, "Made in Germany" carries the greatest weight, and Italy, the UK and France also score high.

In the US, the country that seems most likely to slap high tariffs on European goods, American-made goods are the most popular, but German-made ones come second, and France and Italy enjoy some cachet, too.

The difficult part, of course, is translating these perception differences into prices. It would take detailed research into specific products to figure out what kind of cushion German, Italian and French producers have against tariff pressure. But, if previous studies of the country of origin effect are any guide, the same tariffs should hurt Chinese manufacturers much more than German or Italian ones. Unless imports from Europe can be replaced with goods made in the US, which is unlikely in the short run, German, Italian and French exporters should still be able to sell their goods to the significant percentage of Americans who attach a high value to these countries' manufacturing prowess.

> **Consumers attach a lot of value to the national brands of Germany, Italy and France, and that may compensate for any price increases caused by tariffs**

One other important finding in the YouGov survey is that European goods are disproportionately more popular in the developing world than in the US, and often even more popular than at home. If the US tries to price them out of its market, diverting the exports to the Middle East, Latin America, China and India should ultimately compensate them for American losses.

In a world of trade wars, price competition becomes more difficult and harder to predict. That increases the importance of quality, and thus, of the corporate and national brands that serve as quality guarantees to consumers. Economists need to start building that into their models.

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LETTERS TO THE EDITOR

The immortal Mahatma Gandhi

Perhaps next to Lord Buddha, Mahatma Gandhi is India's greatest son ever. Deified for his courage and compassion, he is still looked up to as a model for generations to follow. In his own lifetime, he became a symbol of the pursuit of truth and non-violence. It is hard to think of any other leader who exercised such a civilising influence on the world in the 20th century as Mahatma Gandhi did. The Father of the Nation has stood the test of time. Even today, he inspires us and fascinates us. We easily identify with the 'half-naked *fakir*' or fragile beauty sporting a toothless beatific smile. Mahatma Gandhi epitomised courage and freed us from the yoke of British imperialism. The might of the British Empire could not make him drop the handful of salt he picked in defiance of the British law. He made it clear that sometimes breaking the laws becomes necessary to win freedom and secure justice. To borrow prime minister Narendra Modi's words, Mahatma Gandhi's teachings act as a moral compass. It was his unshakable belief that the 'means' should be as fair as the 'ends'. Gandhiji represented the 'federation of different faiths'. He imbibed the best in all religions. He made the supreme sacrifice for religious unity and amity.

— G David Milton, Maruthancode

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THE DIGITAL WAY

Growth with welfare

The concept of the Samagra goes beyond convergence of social sector schemes to the creation of a unique database and a common platform for providing entitlement-based, not demand-driven, benefits

INDIA HAS MANAGED to leverage digital technology to usher in socio-economic equity and growth in the last 10 years. Digital technologies are key to Prime Minister Narendra Modi's efforts to make India a $5-trillion economy. The Digital India initiative launched in 2015 has helped improve the delivery of government support and public services. The software industry has revolutionised India in more ways than one. Apart from creating millions of jobs, it also helped the central and state governments to improve governance. The focus on digitising various welfare schemes, creating a robust database and having a universal identifier in Aadhaar helped the government target its welfare efforts and save crores of rupees. Improved delivery of welfare expenditure is expected to have a multiplier effect on economic growth and welfare.

With its more than 1.3 billion population, India had no option but to embrace digitisation to optimise resources for effective outcomes. There are several success stories of Digital India in governance, service delivery, financial transactions, identification mechanism and population register. Efforts are on to replicate these success stories in more areas to facilitate informed decision-making, inclusiveness in financial dealings, creation of a population register and better infrastructure planning.

Digitisation is key to identifying the beneficiaries based on constitutional rights and eligibility for various welfare schemes. It was in 2012 that the first challenge for the Direct Benefits Transfer (DBT) with effective financial inclusion was flagged. All types of financial institutions—banks, post office, cooperative banks, National Payments Corporation of India, payment gateways, credit cards—were creating their digital processes independent of each other. The challenge then was to make the IT talk to each other. The digital evolution of DBT payment was the first step towards creating a strong bridge for financial transactions across financial institutions. For post office and cooperative banks, software that enabled credit into beneficiary accounts in 20 days was accepted. In 2012, the system became operational with all financial software and transaction platforms getting in sync. This became the foundation that allowed the government to make nearly 85% of its transactions with citizens and merchants cashless. Efforts are on to make it 100% as per the recommendations of the five-member high level committee of RBI, of which I was a member.

The efforts towards DBT ran parallel to financial inclusion. This was done by the Jan-Dhan Yojana, but then accounts were open only in banks that constitute 13-15% of financial institutions. Post offices and cooperative banks that handle about 50% and 38% of transactions, respectively, were left out. This resulted in the accounts at far-off locations becoming non-operative. The need now is to systematically plan and map all financial institutions within a 5-km radius for ensuring improved financial inclusion and more digital transactions.

Digitisation brought in a paradigm shift in governance—from welfare mode to entitlement mode. The need is to have a robust real-time household-wise database that will allow the government to disburse entitlements instead of waiting for anyone to apply. The UN had set the Sustainable Development Goals to ensure that no one is left behind. Robust data is needed to make sure the last one in the queue, who is unlikely to approach the authorities, is able to get the benefits. Madhya Pradesh pioneered in this area with the *Samagra* experiment, which is now adopted not just by eight states, but also by some foreign countries. The concept is to have a common household database instead of silos of individual databases that have evolved over a period of time. Many a times, these databases do not talk to each other and are updated at different frequencies. Aadhaar may have helped avoid duplication in many cases, but in this case it may not be of help as the household is the basis of entitlement. A household database with a unique number assigned to each household was built up using the Socio-Economic Caste Census and the National Population Register data. The common household database, thus, had verified parameters such as BPL, address, gender, caste, bank account number seeded for once as per the choice of individual. Aadhaar was used only as the identifier. This common household database was then subjected to NIC developed software Samagra. All government departments that provide wages, scholarships, food security, housing, differently-abled assistance, health and labour worked in their own security protected vertical columns. The benefits once given were available in read-only mode. Thus, for any given time, the household data was updated as modified for birth, death, migration, split in household family, addition/subtraction due to marriage. This enabled linking of schemes and health benefits with the software. The claims went up manifold, while ensuring the benefits reached as per entitlement. The common household database is also used in the government's health insurance scheme Ayushman Bharat.

In Sanskrit, *samagra* means all-comprehensive, integrated—and that precisely defines its vision. The concept of the *samagra* goes beyond convergence of social sector schemes to the creation of a unique database and a common platform for providing entitlement-based, not demand-driven, benefits. This represents a much-needed paradigm shift from social sector schemes in silos and databases that do not talk to each other, to rationalisation of schemes and streamlining of the procedures involved in imparting benefits based on entitlement.

To be effective, the data should project the status of a household, its entitlements, and the benefits imparted to the household and its individual members. This is what the Samagra does—it captures all the required household-based data with verified parameters of caste, age, SECC status, vulnerability and the masked bank account and Aadhaar number that saves the pain of seeding them again and again in different databases.

A common database enables rationalisation of different schemes for the same or similar objectives spread across departments. Take the example of assistance for marriage of girl child scheme. This was operated by different departments including the minorities commission and the SC/ST commission with different amounts given. A common database helps avoid duplication and ends the need for applying for entitlements several times. The Samagra weeded out duplication of premium payment to the LIC for BPL, by fisheries department, by *mandi*, etc. The claim settlement also got streamlined as the LIC linked to Samagra database and thus once the death certificate is uploaded by the authority and eligibility is checked being BPL/labour/fishermen, etc, the claim directly goes into the account of the bereaved wife as the verified account number is already in the database.

The digitisation of government services has not just enabled DBT, but has also reduced wastage of resources and duplication of assistance by multiple departments working for similar objectives. It is a step towards better coordination and convergence amongst government departments and sharing of data. This, along with data security and privacy, remains a major challenge for the government.

Limits to Indian governance approach

MULTIPLE DEPARTMENTS OFFERING SIMILAR, OVERLAPPING, REPETITIVE SCHEMES: Various departments offer similar schemes targeting different categories of people, but the job-portability factor results in individuals benefiting from all or several departments. Since there is no monitoring system, there is no clarity on benefits derived from different departments. This leads to statistical misrepresentations and skewered estimates and strategies.

MULTIPLE AGENCIES INSURING THE SAME PERSON: The preparatory study of Samagra and UNDP/UNICEF reports have found that there were multiple subsidies (for example in insurance) allocated by the state government. Worse, often the beneficiaries are not even aware of all the benefits due to him/ her.

MULTIPLE REGISTRATIONS OF BENEFICIARIES AND NON-SHARING OF DATA: Samagra has flagged that certain agencies such as the Building and Other Construction Workers Board, formed under the aegis of the labour department, have collected cess and registered workers for schemes. These workers are entitled to receive certain benefits, but the same benefits are also being provided under different schemes. This duplication happens because the data is neither shared nor integrated.

NO ACCOUNTABILITY AND TRANSPARENCY: Implementation of these schemes in a proper and transparent manner is a major challenge as the entire work is carried out manually and in an isolated manner. There is little accountability and transparency in such a system and the citizens find it difficult to avail the benefits intended for them in a prompt and hassle-free manner.

MULTIPLE AUTHORITIES GOVERNING SIMILAR SCHEMES: Those in need of a specific service have to approach multiple offices for the benefits of schemes for which she/he is eligible. Take the example of maternity benefits – one has to approach the health department for some services and the labour department for compensation of wages.

NBFC CRISIS

A "heavy-touch" regulation

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As one-size-fits-all is not applicable for NBFCs, RBI should appoint a dedicated advisory committee to assess their health

NBFC CRISIS IS looming large following the failure of a few systemically important financial institutions in infrastructure, financial leasing, and housing. NBFCs leverage on low transaction costs, financial innovation, and regulatory arbitrage (RBI, 2014). Thus, the on-going crisis has received a considerable attention of the regulator and the government.

The Union Budget 2019 announced that only solvent NBFCs can sell their high-rated (AA) pooled assets (of ₹1 lakh crore) to public sector banks and the government can extend a partial credit guarantee cover to PSBs in the case of first-loss up to 10%. While this measure was sought to facilitate fund-raising opportunity for cash strapped NBFCs in the short-run, liquidity problems remain unaddressed.

Prudential framework of stressed asset management and asset liability management have already caught RBI's attention. These are applicable for systemically important NBFCs, NBFCs–ND with asset size of ₹100 crore and above, NBFCs–D (irrespective of asset size) and Core Investment Companies.

Besides this following measures can be considered.

Basel accord: RBI should implement the Basel-IV accord for NBFCs/FIs. The regulatory architecture needs to incorporate market-based indicators attributed to the three important pillars of Basel accord, namely capital requirement, market discipline, and supervisory review.

Consideration of CAMELS approach for systemically important NBFCs can help with Basel-IV implementation.

Further, capital requirement can be reduced—9-12% (6-8% of Tier I plus 3-4% of Tier II capital) from 15% current level—from source of funding point of view. The amount of discretionary financing needed will also be reduced as NBFCs can use their surplus or retained earnings for internal financing putting an end to current fund-raising problems both from money and capital markets.

> NBFCs have more long-duration assets than liabilities. Hence, they need to finance their fixed-rate assets with floating-rate liabilities

Investment maturity: NBFCs need to shift their interest sensitive assets or change the blending of investment maturities as interest-rate expectations change (riding the yield curve). For example, investment portfolio can shift toward long-term maturities when interest rate is expected to fall (as can be seen from a downward sloping yield curve). They can bucket interest sensitive assets to short-term maturities if interest rates are expected to rise (from an upward sloping yield curve).

NBFCs can improve their liquidity position and avoid a large capital loss in case of upward movement of interest-rates, by adopting a front-end load maturity policy. They can maximise their earnings through a back-end load maturity in case interest rates fall. Both strategies can improve earnings potential.

Interest rate risk management: NBFCs have more long-duration assets than liabilities. Hence, they need to finance their fixed-rate assets with floating-rate liabilities. However, as NBFC's credit-rating has already plunged, they are likely to pay a fixed-rate interest on deposits and receive a floating-rate interest on loans and advances. Thus, using interest-rate collars (combination of cap-rate and floor-rate) similar to long-call and long-put options can help NBFCs.

More importantly, as a one-size-fits-all is not applicable, RBI should appoint a dedicated advisory committee. Periodic review of their operations, financial disclosure can help take ex-ante corrective measures. The committee can refer to terms of reference and conduct a bi-monthly meeting to discuss the state of NBFCs in financial landscape—lending and borrowing quantum, external benchmarking, product-market mix and asset securitisation.

While the virtue of regulatory arbitrage has pushed several NBFCs to face headwinds of shadow banking, lack of due diligence and poor asset transformation strategies has moved net-NPAs to 6.6% in FY19 from 5.0% in FY18. Therefore, any short-term stimulus will not heal the wounds of the sector. Instead, RBI should have more bandwidth and autonomy to regulate the NBFCs to face headwinds of debilitating NBFCs.

This is a strip-down version of an article communicated to Lucknow Management Association at World Trade Centre for a panel discussion: 'Strengthening the NBFC sector' held in August 2019.

A bumpy ride

Economy should not miss the important link between the automobile and the infrastructure sector

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INFRASTRUCTURE, AS IT creates capacities, generates employment and increases efficiencies, was the most talked about and searched term a couple of years ago. In the early part of the decade we were talking about $1 trillion-dollar infrastructure investment, the dream, now, is to achieve a $5 trillion economy. And, the government is investing heavily on infrastructure to support India's long-term growth. India is far ahead than many emerging economies in terms of providing qualitative transportation related infrastructure.

India has achieved fair amount of growth in the infrastructure segment, typically, in ensuring connectivity via airways, waterways and roads. Although, regional connectivity scheme UDAN and Sagarmala initiative are yet to achieve potential, road network is getting tremendous impetus.

Under the ambitious Bharatmala Pariyojana the government plans to develop about 35,000 km in Phase-I at an estimated cost of ₹5,35,000 crore to provide seamless connectivity to interior and backward areas and borders of the country.

In the Union Budget 2019-20, the government allocated ₹1.12 trillion ($15.48 billion) expressing its intention to maintain the momentum in road expansion projects. Highway construction has increased to 10,800 km in FY19 from 4,260 km in FY14. As per the latest estimates there are 225 projects, with an aggregate length of about 9,613 km, which have been appraised and approved under Phase-I of the project. Moreover, various projects put together are expected to provide 14 crore man-days in employment. The substantial numbers speak about the linkages generated by the road sector. As per the toll information system, 512 toll plazas are operating in the country. Moreover, there are 2,363 road projects in the pipeline with a cost of ₹8.62 lakh crore.

The highway construction in India has reported 20.45% CAGR from FY14-19 taking the NH length to 1,32,499 km as on March 2019. However, there are some legacy projects operating under old model, which are facing difficulties on account of debt servicing. Traffic estimates are an important part of the puzzle, and incorrect estimations may result in stressed assets. Some of the well-known Infrastructure companies, today, are under stress and are facing rating downgrades. In the one year period ending July 31, 2019, the upgrade to downgrade ratio for road constructions sector deteriorated by 22 bps to 0.58x from 0.80x.

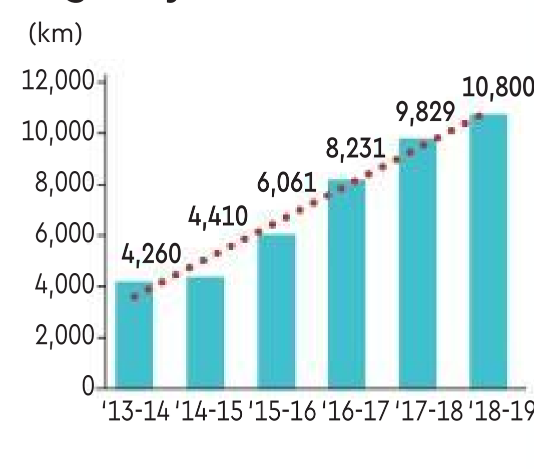
At a time when the economy needs infrastructure push in greenfield projects, the stress in these segments may hamper growth prospects and dent profitability of lenders. It is, therefore, important to analyse the reasons for this decline and the impact of the changes on the economic skyline of the country.

While the road length is witnessing an increase, the traffic forecast of the highway projects may go haywire on account of multiple factors such as Increase in official maximum load carrying capacity of heavy vehicles, including trucks by 20-25% (increased in July'18). The gross vehicle weight of a two-axle truck (two wheels in the front axle and four wheels in the rear) has been increased to 18.5 tonne from the existing 16.2 tonnes, increasing the load carrying capacity by just over 20%. For a five-axle truck, the vehicle weight has been increased from 37 tonne to 43.5 tonne, increasing the load carrying capacity by more than 25%. Statistically, commercial vehicle traffic would also see a decline denting the toll revenue.

Road infrastructure status projects in pipeline

Description	No of projects	Amount (₹ crore)
Completed	553	97,659
Operation and maintenance stage	477	2,06,083
Pre-construction stage	264	1,12,239
Under construction	1,622	5,44,148
Total	2,916	9,60,128

Highway construction



Source: Govt. Portal

Though the decision to increase axle load was taken with a view to increase the carrying capacity of goods transport vehicles and bring down logistics cost, the immediate impact on vehicle sales and longer term affect on traffic assessment may not have been given consideration.

Road sector traffic assessment also has not quantified and factored the likely dent by the future projects such as Sagarmala, which aims to modernise India's ports. The Dedicated Freight Corridor (DFC) network of railway lines would also cause shifting of transport preferences based on cost and convenience. It is pertinent to mention that, road sector exposure, from the banking system, reported a 14.6% growth in June-19, increasing to ₹1,861 bn as on June-19 from ₹1,624 bn a year ago. The overall bank credit during this period grew by 11.1%.

The growth of infrastructure needs a push, but on the other hand, one needs to remember that growth of one sector may stunt the growth of another critical sector. This changing logistics model may give rise to problem with the related entities. Economy should not miss the important link between the automobile and the infrastructure sector. There is a need to take a holistic view for the future of Indian transport sector factoring all the modes (rail, road, ports, and air) and not in isolation.