ETW 5th to 11th August 2019

CAG and ministry of finance spar over off budget financing (BS 5/8/19)

- CAG has conveyed to the government that raising money by entities such as IRFC, PFC, FCI and special banking arrangements for fertiliser companies total about ₹ 3 tn sand this should be included in the budget numbers
- Once included the fiscal deficit would expand to around 6% as against the budget estimates of 3.3%
- CAG has raised this issue in a report tabled in parliament and in the recent presentations to the 15th FC
- The auditor has asked the government to put in place a framework for off budget financing, which among other things would include disclosure to the parliament
- On the other hand, the finance ministry officials have stated that the FRBM (Fiscal Responsibility and Budget Management Act), has empowered the centre to keep the off budget financing out of fiscal deficit calculations. As per the FRBMA, the extra budgetary resources are the part of the debt and not part of the fiscal deficit calculation. Hence the government also claims that the FD calculated by the CAG is a subjective one
- As per CAG, the off budget financing has increased in recent years because the government is trying to meet the increasing demands for subsidy and capital expenditure (for example the carry forward liability of food and fertiliser subsidy has been increasing from 2011-12 and is averaging at around 0.5% of GDP

IBC and Operational Creditors (BS 7/8/19)

- A key feature of IBC (Insolvency and Bankruptcy Code) is that the operational creditors (some of the lenders, suppliers, employees etc) are not allowed to participate in the voting process in the Committee of Creditors (CoC) which would be deciding the fate of the company
- This feature is very unique to the Indian law and has raised concerns about the equitable treatment for the operational creditors. In case of other countries though the unsecured creditors are a part of the Committee of Creditors, the recovery is very less or nothing
- Many have said that they should also be given a say in the resolution process, but the issues are
  - The operational creditors are many and the time taken for them to collect and submit their claims could be very high and would also be expensive process, added to this, the interests of all these creditors will vary, which will make it very difficult to deal with them (for example the interests of supplier and employees)

        - The operational creditors have a strong bias against liquidation. This during voting may prohibit from making an efficient decision making. This is because the operational creditors are at the bottom of the priority waterfall and in case a company is liquidated, the recovery will be hit
- What is the flip side of not including the operational creditors
    - The suppliers may either reduce their exposure or demand advance payments even if there is a slight sign of distress. This may in fact speed up the deterioration of the company
- Having said so,
    - Of all the cases filed under IBC, more than 50% of the cases have been filed by the operational creditors. Which means they favour IBC compared to any other means of recovery
    - The recovery of the operational creditors has been slightly higher than that of the financial creditors (Affidavit filed by IBBI with NCLAT). This data does not even take into consideration the fact when the companies are bought by another company under IBC, they continue their relationship with the new owner

Reviving Investment - but how? (BS 7/8/19)

- Present situation
    - Consumption is sharply down
    - Investments have become dormant
    - Exports have flat lined
    - Capital formation has dropped
- Budget has identified infrastructure as the one which will lead to revival. The public investment in infrastructure would create jobs and this would lead to higher consumption and investments (this would lead to the virtuous cycle)
- So the next question would be does the government have sufficient resources to have sufficient investment in infrastructure or there is a need to be dependent on the PPP, if so then what should be done by the government so that the private sector starts to invest in the infrastructure
- There is a very limited fiscal space available for the government to increase its investment in infrastructure
- The past experience with the PPP has not been encouraging
    - PPP does not have all the infrastructure under its ambit. Majority of the projects implemented are in transport sector (highways and airports)
    - Many PPP projects have faced issues such as delays in obtaining required clearances (forest or environmental clearances), land acquisition, unresolved structural issues which affect the commercial viability of the project. As a result of this, many of the projects are stranded, abandoned

  - In the last five years, PPP projects have not implemented. Most of the projects are being implemented under EPC (Engineering Procurement and Construction) model, no major airport modernisation has been taken up
  - A committee to address these issues was set up in 2015 and its recommendations are yet to be implemented. Now the govt has proposed another committee in the budget to address the issues
- Beyond this, it is possible to attract private investment but in many sectors, such investments have dried up because of stranded assets and large commercial losses
  - Power sector provides one such avenue. The Gencos are under financial stress, govt's UDAY has not yielded expected results, Discoms are dragging their feet and are incurring losses etc. Until the distribution end of the system is fixed, there can be no viable investment in generation and transmission
  - Another example is Coal. Despite having huge coal resources India imports over 200 mn tons of coal each year. Then what would be the need to keep the coal sector nationalised?
- The only way out of this slowdown (which has structural overtones), is that the government should implement reforms
  - These should be structural in nature
  - These should be front-loaded (should be announced soon rather than being announced during election season)

PSBs link lending and repo rates (TH 10/8/19)

- In order to have a faster monetary policy transmission, PSBs are starting to link their lending rates with the repo rate of the central bank
- Bank of India, Syndicate Bank, Allahabad Bank and Union Bank have announced that they would be linking their lending rates to the repo rate
- These banks have also reduced their MCLR (Marginal Cost of fund based Lending Rate) days after MPC announced a cut in repo rate

India should act tough and exit RCEP (BL 6/8/19)

- India in the recently held RCEP talks has stated that it would enter RCEP only if its concerns related to its trade deficit with many countries is taken into consideration
- RCEP with third of global GDP, 40% of exports, around half of the global population, seems too difficult to ignore but one thinks lucidly India may not lose out on much if it decides to keep out of RCEP
  - Average import tariffs in the region are 6.8% compared to 13.8% imposed by India on industrial and agricultural imports. Moreover, some of the countries such as Japan, South Korea etc have very high tariffs on certain products such as rice,

footwear, honey, dairy products etc (these countries may continue to shield them by keeping them in sensitive lists)

- Even if China agrees to reduce tariffs on many products, the exports from India may not substantially increase because it imposes a large number of non-tariff measures. Whereas if India agrees to reduce the tariffs even on 70% of the items coming from China, the market could get flooded with these products
- Even in the case of India seeking service sector exemptions (which would allow movement of professionals from India), it is doubtful if it will get any substantive returns. The fact of the matter is the ASEAN countries are very sensitive towards the services sector and have not liberalised the sector within the block itself
- India has a trade deficit of $105 bn with RCEP partners and by eliminating tariffs, it would limit the tax revenues (customs)