

# Opinion

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## Rational Expectations

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## Loan waivers or atonement?

Whether it is higher MSPs or loan waivers, these result from govt blocking export and other markets for farmers

**CHIEF ECONOMIC ADVISOR** Arvind Subramanian, it appears, will be re-flagging the impact of farm loan waivers in the second volume of the Economic Survey later this month. “We will provide”, he told *The Hindu BusinessLine*, “data and calculations to show how the farm loan waivers will impact not only the finances of the respective states but also those of the Centre”.

While the impact of any loan waiver on the fisc is well-known—see how it goes for a toss when the Centre has to provide for PSB NPAs—Subramanian would do well to look at the other side of loan waivers, that they are a direct response to poor government policy. If government policy is good, there will be little need for loan waivers.

When, in response to prime minister Modi’s election promise, UP chief minister Yogi Adityanath announced a farm loan waiver, ICRIER professor Ashok Gulati pointed out that the size of the loan waiver in the state was roughly equal to what the farmer lost out over three years by not getting the MSP that the government had promised to pay for wheat and rice—Gulati took data on how much wheat/rice prices in UP were lower than the MSP and multiplied this by the amount of production.

But, the argument goes, the MSP itself is a favour the government is doing for farmers. *Price Distortions in Indian Agriculture* by Shweta Saini (senior consultant at ICRIER) and Gulati provides evocative examples of what poor government policy has resulted in. The impact is not just in cereals like wheat and rice where there is an MSP, but in crops like onions and potatoes where there is no MSP and which are at the centre of the current farm crisis.

In the case of wheat, the export ban lasted more than four-and-a-half years, from February 9, 2007, to September 9, 2011. To put the loss to farmers in perspective, after the ban was lifted, wheat exports rose to over \$5 billion in 2012-13. Saini-Gulati’s analysis of local prices and global prices shows that in five of the 10 years between 2004-05 and 2013-14, Indian wheat supplies were globally competitive, in four years, they could have held their own against imports—only in 2010-11, were imports cheaper.

In the case of rice, a host of restrictions by way of minimum export prices (MEP) were imposed between 2007 and 2011. On October 15, 2007, for instance, an export ban was imposed on non-basmati rice and, 15 days later, this was replaced with a MEP of \$425 per tonne; this was raised to \$500 on December 27. Exports were banned again on February 7, 2008 but on March 5, this was replaced with a MEP of \$650. Between 2007-08 and 2011-12, Saini-Gulati point out, common rice export restrictions created an implicit export tax. Before the ban, between 2004-05 and 2007-08, domestic prices were about 80-90% of world reference prices; however, during the ban period, these prices were 70% of world prices (except for the year 2010-11 when international prices fell).

Similar analysis has been done for most crops and even milk and meat. Dairy exports, for instance, were banned between February 8, 2011 and June 8, 2012 though the report shows milk was competitive in five of 10 years, could hold its own in one year and was uncompetitive in four years (see graphic). Had exports been allowed, for most crops, farmers wouldn’t need MSP-based procurement by government or even loan waivers.

In the case of onions which were not just export-competitive in all 10 years, but by a huge margin, MEPs were raised dramatically in 2013-14 and 2014-15 to stop exports. Exports were banned in December 2010 and September 2011 and, in November 2013, the MEP was raised to \$1,150 per tonne; it was then lowered but increased dramatically, from \$250 in April 2015 to \$700 in August 2015, to return to being free by late December 2015. In the case of potatoes, too, except for one year in which they could hold their own against imports, they were very competitive—an MEP of \$450 was put between June 2014 and February 2015 to restrict exports.

And while procurement by FCI is portrayed as another sign of pampering farmers, Saini-Gulati show rice stocks with FCI jumped from 8 mn tonnes to over 20 when, between October 2008 to September 2011, all manner of export restrictions were imposed. With the government squeezing farmer profits all the time in order to keep consumer prices low, MSPs, subsidies and loan waivers have emerged as a way to keep the opposition muted—they are most certainly not a favour being bestowed.

## AdSENSE

The govt does well to pre-empt any misinformation/lack of clarity on GST with ads

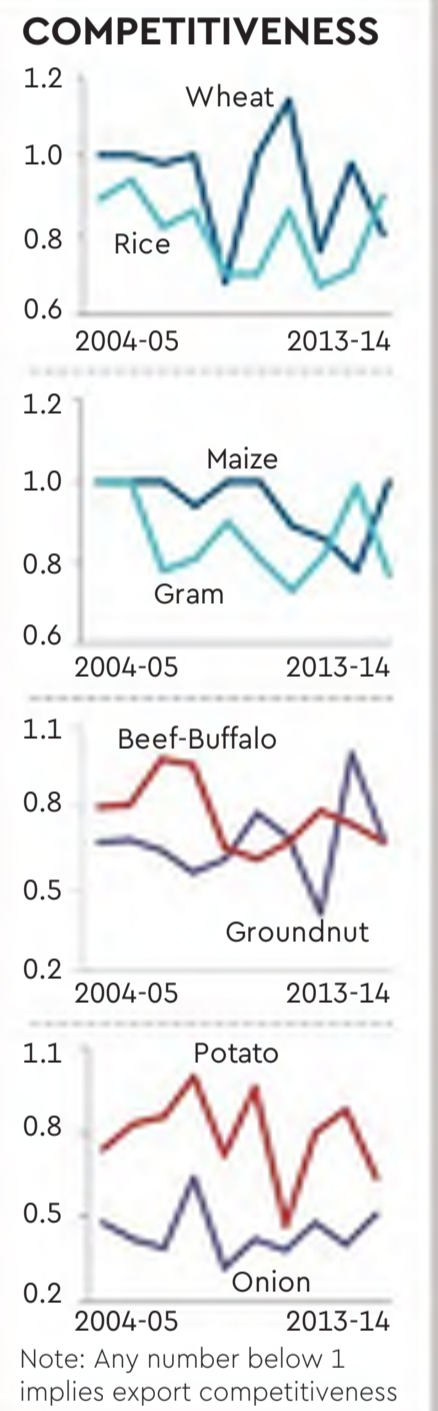
**MANY GOVERNMENTS, INCLUDING** the present one, have been criticised for splurging on ads when it was not needed, and being closeted when more generous spending on marketing a particular effort was required. However, the Union government has got it right with its new campaign to dispel misinformation and lack of clarity on GST via advertisements across media. While demonetisation had led to rumours of prices of salt and sugar increasing with certain retailers charging higher prices, the government has done well to pre-empt such canards about GST. By specifying the rates applicable on items of daily use like milk, wheat, rice, soap, sugar, toothpaste, it has signalled that it is ready to pull all stops to prevent unscrupulous elements benefiting off the teething troubles of GST by fleecing consumers. There is a definite PR-ish feel to campaign—the ads feature only those items for which the tax rate has fallen or remains unchanged—but given the initial confusion is fertile ground for price gouging, the government has done well to state the rates up front and clear.

The effort, however, should not be limited to just this instance, as misinformation or incomplete information on many initiatives abound, especially on social media. The government can very well take the ads route to promote its digital payment initiatives—BHIM, for instance, could use some concentrated marketing efforts. With the BJP trying its best to show this as a personal victory for the prime minister and asking its legislators to promote GST across the country, it would do well to engage its machinery to address people’s concerns on prices as well. More important, the government needs to ensure that there is a constant stream of information to counter rumours, if any, about prices increasing under the new tax regime for the next few months.

*History repeats itself because no one was listening the first time.*  
—Anonymous

**T**HE CALL TO institute a floor price for data services in telecom reflects a growing aggravation on part of the incumbent telecom operators on dealing with simultaneous and sudden attacks on their revenues streams. It started in 2013, with ‘unlicensed’ services like WhatsApp and Viber eating into SMS and voice revenues, affecting balance-sheets already suffering from high leverage due to spectrum auctions. The incumbents allege that spectrum auctions have been designed to result in high acquisition costs. In the aftermath, incumbent telecom forms lobbied the governance institutions, DoT and Trai, for relief—in the form of lower licence fees and regulatory burden, on the one hand, and the institution of a regulatory regime for content providers that rode on telecom networks for their market but were out of the purview of licensing, on the other. They argued persuasively and, on occasions, justifiably that unlicensed and innovative content providers exploited infrastructure set up by them over several years of massive investments, braving competition and regulatory barriers. It wasn’t easy to get where they were. And having gotten there, ‘unfair’ competition was eroding their ability to provide quality and quantity to the Indian public. The regulators listened, the rhetoric grew shrill at times but relief was not forthcoming either in the form of regulatory burden being lowered significantly or the content provider’s costs of doing business being raised. The discussion on ‘net neutrality’ continues unabated in its ability to polarise.

No sooner had the incumbents established peace with the new reality, another disruption, arguably more ruinous than the first, struck—Rjio’s offers of extremely aggressive voice- and data-plans. There are some peculiarities with Jio’s entry—one, the broader perception is that it is not the classic new entrant in the telecom space, and two, while it has a very small presence in the relevant market, it is hardly accurate to perceive it to be at the mercy of the incumbents and at favour of the regulator. Competition law, however, takes a narrow view in the matter of abuse of dominance, maintaining that predatory conduct can only follow from market dominance. The Competition Commission of India (CCI) has dismissed allegations of predatory pricing against Jio since it holds approximately



## TELECOM TROUBLES

NOT ONLY WILL IT BE HARD TO ARRIVE AT A COST-BASED ESTIMATE OF A FLOOR-PRICE IN A CONVERGED SERVICE ENVIRONMENT, MONITORING IT WILL PRESENT INSTITUTIONAL CHALLENGES

# Drop the call for price-floor

RAJAT KATHURIA, MANSI KEDIA, KAUSHAMBI BAGCHI & GANGESH VARMA

Kathuria is director and chief executive, and Kedia, Bagchi & Varma are consultants, Icrier. Views are personal

9.29% of the subscriber market-share as of March 2017, which is far from dominant.

The recent developments have provided impetus to consolidation, reflecting increasing competitive pressure on incumbents. Even as we were writing this, reports were coming in that Airtel may acquire Tata Teleservices. After all the jostling for space and fight for market-share, a new steady state will emerge. From the perspective of markets and competition, it is important that the financial health of the sector is preserved in the long-term interest of all stakeholders. Competition will always weed out the stragglers. But it can be nobody’s case that ‘good’/strong firms are driven out of the market.

The sector has been instrumental in delivering massive social and economic impacts, and its survival is key to India’s economic interests and several initiatives around Digital India. Not just subsistence, but existence of strong players that can invest in technology, ultimately conferring benefits to users, companies and consumers. Thus, healthy finances are not only desirable for the sector, but for creating a robust platform for Digital India. Based on current data, the industry, however, seems

to be in financial trouble. The change in revenue, profit, debt and interest coverage ratio over the last financial year for top three operators show a discernible decline. For the first time in many years, annual revenue of Indian telecom firms declined to ₹1.88 trillion in FY17 (from ₹1.93 trillion the previous year). Telecom industry’s debt to the banking sector is estimated at ₹4.6 trillion. With a total industry ebitda of ₹650 billion, the debt level seems unsustainable. So, where do we go from here? The dramatic entry of Jio has sent data prices crashing and inevitably set off a price war. The accompanying graphic confirms the trajectories of voice and data prices in India, respectively, albeit over different time periods. The data show that the price for voice collapsed beginning 2003 with the introduction of calling party pays (CPP) and has stayed impossibly low since. Incumbents then were able to benefit from the cushion of a ‘high’ voice tariff for several years before regulatory intervention and competition (once again, from a Reliance stable) destroyed the equilibrium and sent voice tariffs crashing. Perhaps data prices would have also followed a similar path, but for the abrupt data price war initiated by Jio.

Between March 2016 and December 2016, there was a remarkable jump of close to five times in data usage, from 147.12 MB per subscriber per month in March 2016 to 878.63 MB per subscriber per month in December 2016. The corresponding price decline measured in rupees per MB was 83.58%, reflecting a very high price elasticity of around 6.

The paramount question is what, if anything, can the regulator do? Is prescribing a price floor the answer? Setting a price floor is not a novel idea. Recent examples of countries introducing price floors in their telecom markets are Sri Lanka and Zimbabwe. In 2016, Sri Lanka enforced a common minimum retail voice call rate for on-net and off-net domestic voice calls. Earlier this year, Zimbabwe’s telecom regulator, the Postal and Telecommunications Regulatory Authority of Zimbabwe, set a price floor for traditional voice services at 12 cents per minute and that for data at 2 cents per megabyte. In both countries, the measures were driven by price-war situations which led to declining revenues. In both, there has been extensive criticism and the sector’s health has not improved.

A price floor will be a blunt instrument for India. Apart from it being awfully hard to arrive at a cost-based estimate of a floor-price in a converged service environment, the ability to monitor and enforce it will itself pose several institutional challenges. Add to that the negative perception of it being anti-consumer regardless of the possibility that it will strengthen the sector in the long run. Consumers have benefitted immensely from competition and the attendant decline in prices of voice and data services. A return to *ex-ante* tariff regulation from regulatory forbearance could create a pro-business perception among consumers of Trai. So, are things likely to get worse before they become better? Not really, but it requires the regulator to take a holistic view of the sectors economic contribution, regulatory costs and technological changes and thereafter summon non-intrusive policy instruments in an already competitive and dynamic sector. In 1999, the government, on a collective plea by private sector mobile operators, agreed to reduce their licence fee burden that threatened business continuity. The sector successfully migrated to the revenue-share licence fee regime that continues today. The situation now is arguably worse than it was then. And a price floor is unlikely to restore the sector’s financial health. Is it time to think out of the box again?

Financial health of top 3 operators (FY2016-17)

	Revenue Δ 16/17	Net income Δ 16/17	EBIT Δ 16/17	Debt/equity ratio Δ 16/17	Interest coverage ratio Δ 16/17
Airtel	-1.10%	-37.47%	-5.68%	8.00%	-26.35%
Idea	-1.44%	-131.41%	-55.69%	39.57%	-240.73%
Vodafone	0.50%	NA	-10.15%	NA	NA

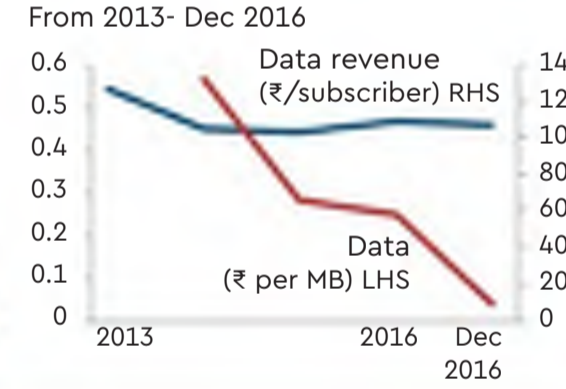
Source: Compiled by authors by company annual reports and media

Price of Voice



Source: Compiled by authors from TRAI data

Price of data and revenue



## Worrying about what?

The West is recovering slowly, but central banks must take the markets along with them when they taper

MEGHNAD DESAI

Prominent economist and Labour peer



**THE GLOBAL FINANCIAL** markets are in a very peculiar state. The volatility index, VIX, is at its quietest. Inflation is low, and below the target value of 2%. Growth is low as well by historical standards, but it is higher than it was five years ago. In the euro zone especially, the revival of growth has been the slowest in coming, but it is here.

The Federal Reserve has increased its rate twice this year by 25 basis points. It is thinking aloud about one more increase this year. The Labour market is tight and though the growth rate is not spectacular (around 2%), the Fed thinks ahead of the curve and wants to ensure that it is not surprised. It is also thinking about tapering. Doing so will depress bond prices and increase bond yields. If there is a need for higher rates, then tapering would be the right thing to proceed with. The Fed is again being cautious in the pace of tapering. It does not want a collapse in the bond prices just to get its balance-sheet looking healthier. Nor does it want to have to reverse its policy either way. Thus, the pace of tapering, as and when it happens, is crucial.

In thinking explicitly and openly about tapering, the Fed is setting an exemplary tradition in transparency and preparing the markets. Other central banks are more old-fashioned, treating any frank and open remarks by the central bank leader as a breach of tradition. This leads to perverse problems. Mark Carney, the Bank of England (BoE) Governor, had ruled out any increase in rates arguing that the UK economy was not anywhere near as tight as the US economy. Even so, there is an argument

going on within the BoE as to when, not if the rates would go up. Similar situation prevails in the Eurozone. Mario Draghi had been signalling caution.

But the situation is febrile whatever the VIX may say. People recall that while central banks worried about price stability, it was (the lack of) financial stability which caused the crash in 2008. The Phillips Curve may say one thing but financial stability dictates something else. This was seen last Thursday in the bond markets. At a meeting in Portugal, Draghi seemed to add some sunshine to his usual stance. Mark Carney also reversed his position and said rates could go up. This caused an unseemly dumping of bonds.

The markets know that the long period of low rates has to end sometime. No one knows however when the turn may come. Hence, the nervousness. There was also some over-interpretation of what was being said. Draghi ended his speech in Portugal with his usual caution. But by then the journalists had already retailed the bullish views he expressed in the early parts of his speech. Smartphones rushed the news to the market, and mayhem followed.

What all this means is that financial stability cannot be taken for granted. Central banks have to communicate more openly and more often as to when they may raise rates, and even more important, when they may start tapering. For about 30 years after Paul Volcker changed the course of monetary policy and raised rates sharply to control inflation, central banks worried only about price stability. They speak lately of macro-prudential stability,

but markets are jittery despite their talk.

The problem is that while the monetarists had a theory of inflation, and the Phillips Curve was fashioned into a tool, no one has modelled financial stability with the same assurance. In 2008, we realised that we know little about the dynamics of financial stability. The extreme reaction in the bond markets tells us that there is a deep fear of a repeat of 2008. No one can model or predict when the next crash will come as come it must. While QE was being undertaken, no one gave much thought of how it would be reversed. The banks and corporations are flush with the money they got for the bonds they unloaded. They are holding on to the cash or have invested them in assets which can give them a decent yield, i.e., in riskier assets. Central banks have to take the markets along with them when they taper.

A rise in rates in the G7 will affect many emerging economy corporates who have borrowed freely abroad while rates were low. This is the biggest danger to India and other developing countries which could grow faster, thanks to the dollar loans. If, however, the central banks of the rich countries refuse to heed the needs of the Third World, then heaven help us. We could get into a replay of the Asian crisis of 1997-99 due to rising interest rates and corporate defaults from the developing countries. We need more communication, more deep analysis and closer coordination across the globe to avert the possibility of a second meltdown in 12 years.

## LETTERS TO THE EDITOR

### Decoding Modi’s overtures to Israel

It is not just media hype; prime minister Narendra Modi’s visit to Israel is indeed an important event. It marks a marked shift from India’s time-tested stand on the long-running Israeli-Palestinian conflict and signals India’s willingness to lend legitimacy to Israel and alter the strategic balance in favour of the Jewish state. If diplomacy must be tempered with a country’s long-cherished values and ideals, we cannot drop or dilute our long-standing support for the Palestinian cause despite its rightness for reasons that cannot justify it and give Palestinians a short shrift. Till now, India has stood out as a major democracy in the world that has openly and consistently sided with the Palestinian cause. The description of the relationship with Israel as “special” by the Indian Prime Minister is too generic to fathom its real import, unless it suggests an inclination on India’s part to take a blind bit of notice of the questions of Israeli occupation and Israeli settlements. To equate Hamas with LeT is to create a false equivalence to put all Islamic organisations on the same footing.

— G David Milton, Maruthancode

### Climate denial

Trump’s dream of making America great again should, *inter alia*, unfailingly include reduction of fossil fuel consumption and dependence. However, being a climate-sceptic, he chose to cock a snook at climate-change mitigation efforts. This is in sharp contrast to the prudent energy policies embraced by few of his own party predecessors.

— CV Krishna Manoj, Hyderabad

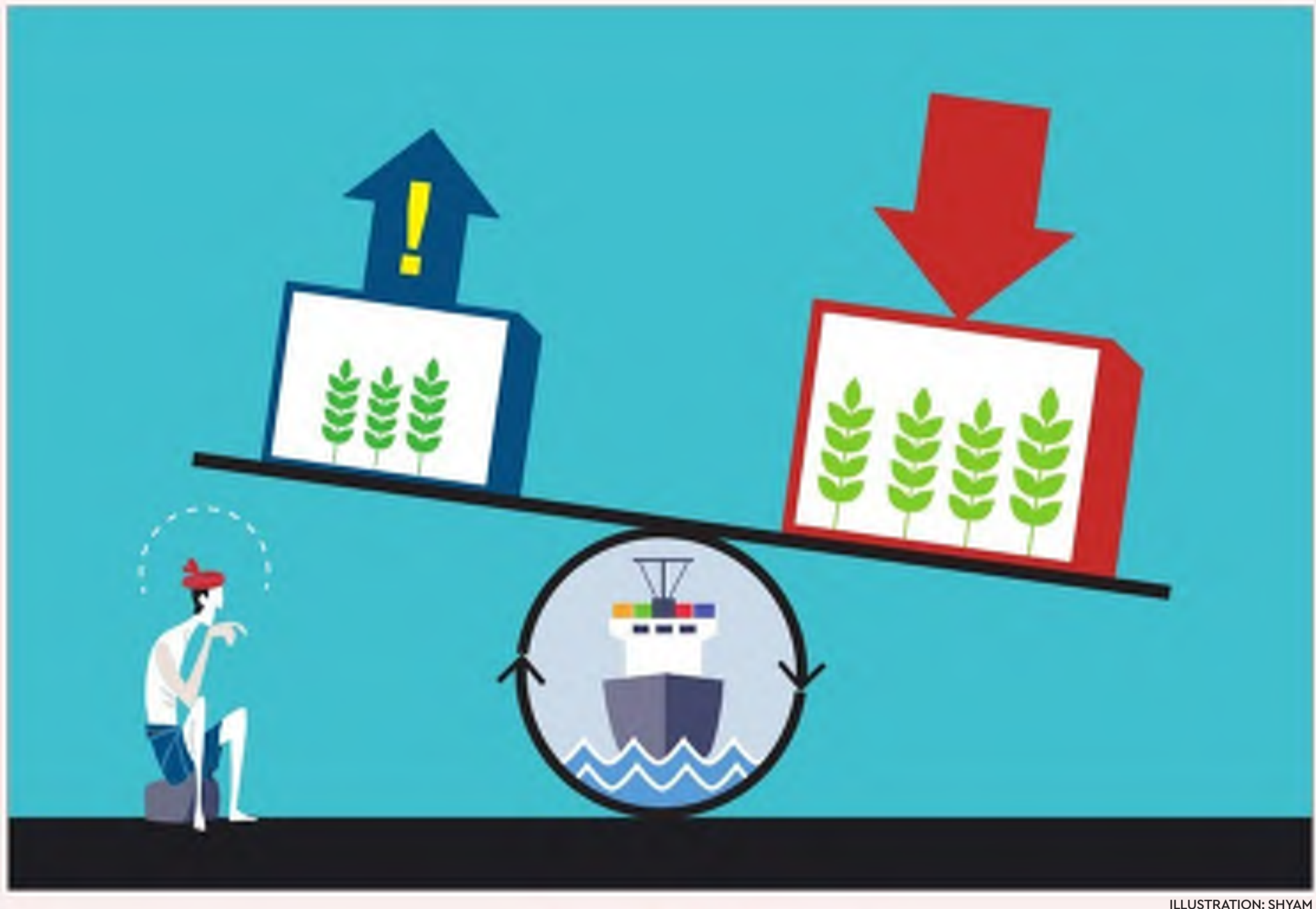


ILLUSTRATION: SHYAM

**TEJINDER NARANG**

Grains trade expert



# Importing an export problem

India is becoming a high cost economy in agro-related items. If it continues to dither in export earnings owing to lack of quality/procedures/poor yields/price parities, resultant suffering will be transmitted via trade to the farmers, and another undesirable cycle of joblessness and loan waivers will commence

**T**HERE IS A RISE of 30% in value of imports of three essential agro items, namely wheat, pulses, vegetable/edible oils—indicative of substantive demand pull in the country (see accompanying graph). Data analysis of India's seven select but vital agro-related items of exports reveals that there is a sharp slump—40% in their overall value—during last four years. Commodities are wheat, rice, sugar, cotton, soy meal, guar gum and beef+fish.

Exports falter when goods are not competitive or if there is a lack of local production and/or poor demand overseas. Edible items are of daily use. Thus, with rising population, the probability of lower demand abroad is not logical. Two successive draughts in 2014-15 and 2015-16 may justify the drop in production, but the lack of adoption of new technologies and efficient farm practices is the root cause.

**Imports**  
Import of pulses jumped from \$2.3 bil-

lion in 2013-14 to \$4 billion—an increase of 74%. Out of 5.4 million tonnes (mt) of pulses shipped to India, 50% or about 2.7 mt are peas/yellow peas from Canada/USA. Kharif acreage of pulses is down by 33% which points to lower output, compelling higher imports of Tur, Urad Moong. News of possible decline in production will make imports costlier. The government has been fronting state agencies for import through bulk tendering. PSUs tenders escalate world prices, thereby pushing up values for private import as well. When state agencies dispose pulses in the domestic market at subsidised prices—that is at a loss—it disturbs the parity of private imports because they cannot discount their costs. This may discourage import, thereby creating more scarcity in the country.

**Wheat**  
From exporter of wheat of about 14 million tonnes (approx \$4 billion in 2012-13 to 2014-15), India has turned into a structural importer of \$1.5 billion of grain in the last three years. Spike in wheat import in 2016-17 over the previous year is 840% by value.

In 2014-15 and 2015-16, market estimates of production each year varied 84-87 million tonnes (though Government claimed 93-95 mt). FCI stocks depleted to 8 mt (buffer norm is 7.5mt) on April 1, 2017, and imports ballooned to about 4 mt in 2016-17, thus validating the market's view.

Wheat procurement of 30 mt this year vs targets of 33 mt implies that OMSS supply to flour millers will be restricted. This necessitates private imports of 5-6 mt in 2017-18. Already importers are looking for cargos from September 2017 onwards from Australia and Black sea at landed values of \$240 and \$205 respectively which will be cheaper than domestic wheat after 10% duty paid.

The government has rightly stayed away from importing wheat directly for FCI and let privates fill the gap. This prudence has kept world wheat prices range bound and non-inflationary, because

traders import in economical lots with the spread of time, instead of bulk tendering by the public sector undertakings (PSUs), which often results in inflated import values.

**Vegetable oils**  
Import of palm/soy/sunflower oils has remained steady—value wise between \$8-9 billion per annum. There are strong pressures from oilseed crushing industry to raise import tariff to create a disparity by having high landed cost of overseas products so that locally produced oil could be cheaper. The government has done well in levying moderate duties on oil to protect consumers—60% of which are based in rural areas including farmers and not to promote inefficient production and processing.

Unless high yielding oilseed varieties are available in the country—the value and volume of vegetable oils import are bound to ascend.

**Exports**  
In 2014-15, basmati/ non-basmati rice exports were \$7.8 billion, this has slipped to \$5.8 billion in 2016-17, but still, India remains world's largest exporter of rice at 10 mt. Poor demand in Africa, especially in Nigeria, of non-basmati rice, and slow down of basmati shipments to Iran and Saudi Arabia could be possible reasons. Iran shipments declined over 50% from 1.44 million tonnes in 2013-14 to 0.7 million tonnes in 2016-17.

The outlook for non-basmati rice for 2017-18 appears positive as strong demand from Nigeria via neighbouring Benin is supportive; Bangladesh requires more than one million tonnes of rice desperately and trade is focused on this demand. Indian non-basmati rice prices are lower than the competition from Thailand, Vietnam, Pakistan.

The success of rice export business is attributed to minimal interference by the government, diversity of paddy varieties, superior capability for par-boiled rice, logistical advantages for Africa, botched-up past policies of the Thai government in paddy pricing and poor performance of Pakistan. Indian rice export is negligible to South-east Asia and China.

**Cotton**  
Cotton exports tapered down from \$3.8 billion to \$1.4 billion during 2013-14 and 2016-17—lower by 63%. Exports to China and Pakistan suffered, while Bangladesh remained a consistent market. India's share of exports to China has dropped from almost 80% in 2011 to 10% in 2015. Indian trade is diversifying to newer markets of Indonesia, Taiwan, Turkey and Thailand to gain the momentum.

**Soymeal/Guar gum/Beef and fish**  
There has been a drastic fall (86%) in soy meal exports from \$2.8 billion to \$0.38 billion; likewise, guar gum exports have been 75% lower and beef and fish have witnessed a 48% decline in 2016-17 from their peak performance of \$10 billion in 2014-15. Beef exports are not likely to pick up because of current confusion. GST complexities is another factor that is bound to affect trade.

We are becoming a high-cost economy in agro-related items. If we continue to dither in our export earnings by the lack of quality/procedures/poor yields/price parities, resultant suffering will be transmitted via trade to the farmers and another undesirable cycle of joblessness and loan waivers will commence.

## InfraTweets

**VINAYAK CHATTERJEE**

Chairman, Feedback Infra  
Twitter handle: @Infra\_VinayakCh



# Checking checkpoint raj

After GST, States are allowed to collect ONLY electricity duty, mandi fee, property tax, and stamp duties. Goodbye "check post raj".

**● Post the checkpoint date**  
On Saturday, govt enacted the long overdue GST regime, spelling an end to check-post raj. States will still collect electricity duty, mandi fee, property tax, and stamp duties. But with the Centre moving quickly to get more sectors under GST—there is a proposal of 12% tax on sale of houses—India will soon move to one nation, one tax regime.

**Single sectoral regulators :NITI A makes a case for a single Energy Regulator. Rakesh Mohan's Transport Report had also pitched similarly**

**● All for one**  
After Rakesh Mohan suggested establishment of a single transport regulator, NITI Aayog is expecting a similar solution to get India energy ready by 2040. An omnibus energy regulator will solve the problem of differential policy decisions, as also provide consumers with a choice using better tech.

**Not a "Dying" Industry : The Int Energy Agency estimates global coal demand to grow at 0.6% per annum till 2021, as against 2.5% earlier**

**● Going strong**  
Coal may be going out of fashion with green economies, but it will not be losing sheen. Although demand is expected to taper from 2.5%, IEA estimates 0.6% growth pa till 2021.

**Tourism Infra gets attention. ₹1500 cr plan for cruise terminals at Mumbai, Goa, Chennai, Kochi & Kandla. 100 cruise ships to go up to 700**

**● Cruising speed**  
Govt is moving to make India more incredible with a ₹1,500 cr investment for cruise terminals, with an aim to attract 10-fold traffic. The move is expected to add 2.5 lakh jobs, and also increase India's share in global cruise tourism from 0.5%. It also sits well with the plan to build better beaches.

**Remember those days when everybody was rushing to set up SEZs. Now Commerce Ministry set to cancel 62 projects where no progress happened**

**● SE(i)Zed up**  
The govt is cancelling 62 SEZ projects, including Cochin Port trust, owing to no progress. Of the 421 approved SEZs, only 218 are operational, but these have created 17 lakh jobs and attracted ₹4.32 lakh crore. With government looking to align SEZ law with GST, there may be hopes of a revival.

**ADB to invest \$ 10 bill in India over 5 yrs. That's ₹12,800 crs per year. Equivalent to funding one Tier2 Metro project each year. Welcome**

**● Invested enough**  
UP, Bihar, Jharkhand, Odisha and Chhattisgarh are to get a major infra push with half of ADB's \$10 billion commitment over the next five years expected to flow to these states. The other half will accrue to East coast economic corridor. This will mark over \$50 billion investment by ADB, over 35 years.

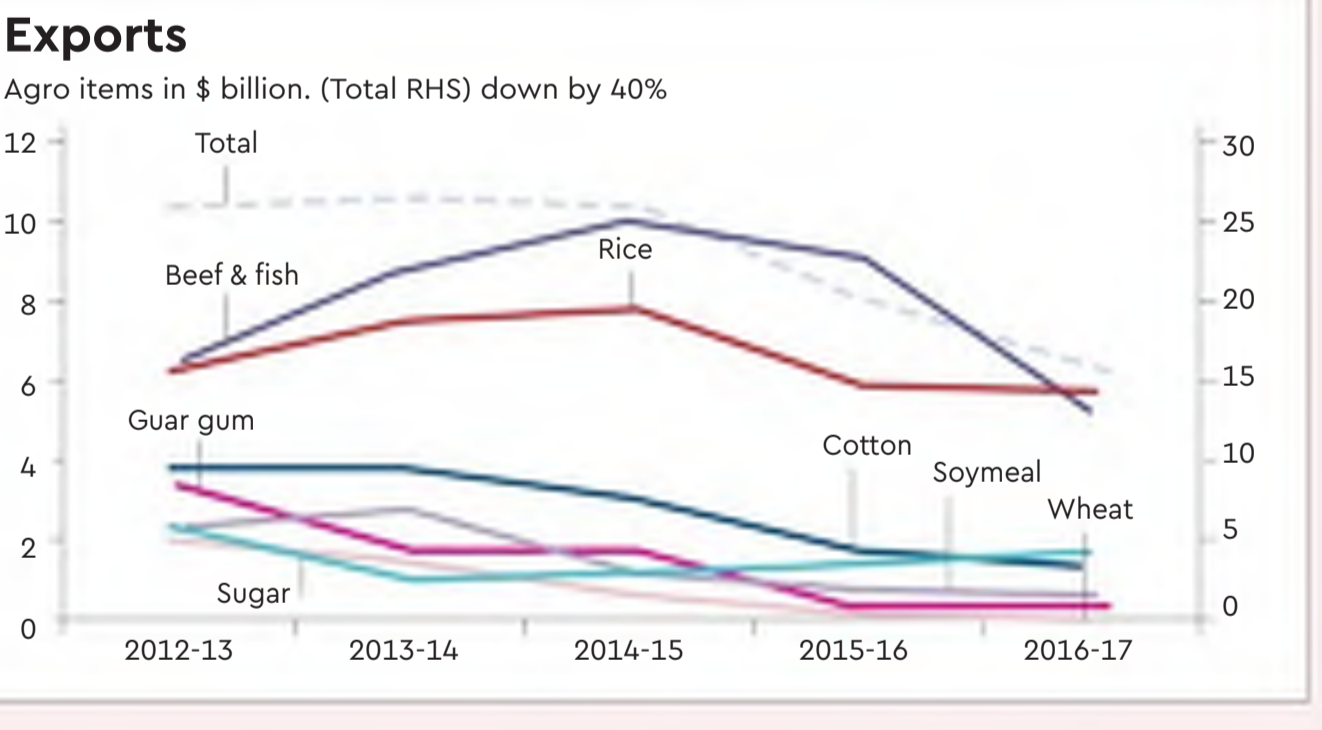
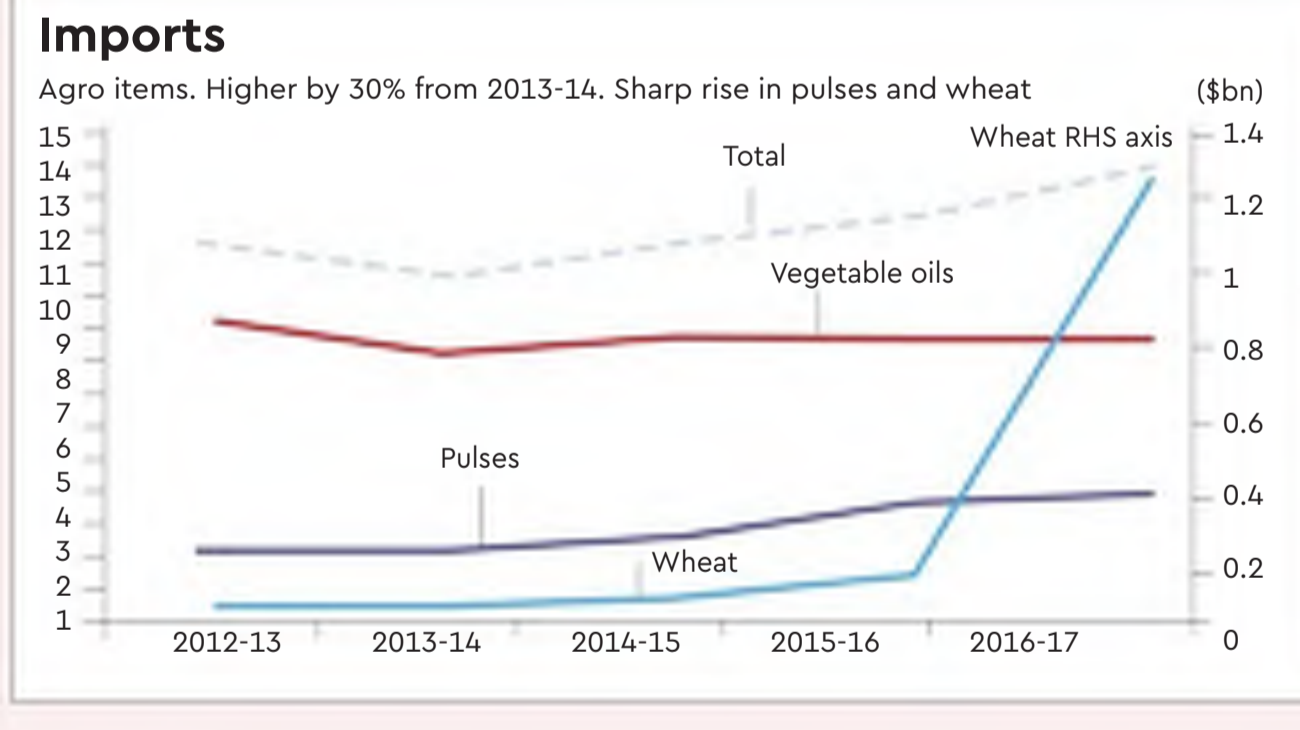
**Cement prodn grew 1.8% in May vs 2.4% decline in April. Maybe indicative of an upturn in construction, but monsoons may dampen trend.**

**● Cementing a place**  
It's too early to write off construction, if new cement figures are anything to go by. Core industry data shows an uptick in cement demand, as production grew 1.8% in May, from a decline of 2.4% in April. Cement accounts for 5.37% weight in core sector.

**About time !! @PiyushGoyal gives state level power Regulators a piece of his mind. Asks them to act independently and professionally.**

**● Regulating right**  
Power ministry may be happy with UDAY performance, but that is certainly not the case with regulators. Talking about non-viable tariffs plaguing investment, and not honouring solar PPA obligations, the minister asked them to act professionally and independently.

A weekly selection of the author's tweets.



**G**ST, THE NEW tax regime, has brought with it a lot of anxiety in terms of implementation. Even in midst of all the uncertainties and challenges, there is confidence that in the long-term it will lead to benefits in the form of higher GDP growth and wider tax base. However, the pertinent question currently is what could be its impact on inflation.

As per the GST tax rates finalised, nearly 50% of the goods fall under the 18% tax rate. In the earlier indirect tax regime, for many items, excise duty plus state VAT and all other taxes added up to more than 25%. Hence, for many of the manufactured goods prices should fall under GST. Under GST, for all goods and services, the producers can claim input tax credit. This means that at the time of paying tax on output, producers can reduce the tax they have already paid on inputs. In the earlier regime, many of the taxes like CST, entry tax, octroi and several cesses were not vat-able. This resulted in cascading effect of the taxes. Removal of cascading effect under GST should also help reduce prices.

The government has introduced an anti-profiteering law under the GST bill to ensure that the benefit due to a reduction in the rate of tax or from input tax credit is passed on to the consumers. While theoretically, prices should go down for many manufactured products under GST, in reality, there could be stickiness in the downward revision of prices and the anti-profiteering law may not be

# Will GST be inflationary?

**RAJANI SINHA & UDIT KUMAR**

Corporate economists based in Mumbai. Views are personal



easy to implement. There is an apprehension of inflation in the services sector. The services sector contributes more than 50% to India's GDP. The GST rate applicable on most services is now 18% as compared to 15% under the older tax regime. This will put upward pressure on prices in the services sector. Service providers will get input tax credit for goods as well as services purchased by them, which will to some extent help in reducing service cost. However, another aspect to be taken into account is that for many of the service providers like banking, insurance, telecom the compliance cost is going to increase under the GST. Under GST they will be required to do state-level registration, whereas earlier the registration was only required at the cen-

tral level. This will add to the cost of the service providers and mitigate some benefits of the input tax credit (ITC). While the anti-profiteering clause says that the service providers have to pass on the benefit of ITC, again it may not be easy to implement. In the last few days, service providers have been intimating their clients about the increase in tax due to GST, but there is still no clarity on reduction in service cost due to ITC. We have to take into account that there are many small/unorganised players also in the market, hence keeping a track of reduction in cost due to ITC could be difficult. Another aspect to be taken into account is that many items are not yet covered by the GST. Potable alcohol, crude oil, natural gas, aviation fuel, diesel, petrol, electricity and real



estate are currently out of GST, and states will levy their own taxes on these. Take the case of petroleum companies, their final output petroleum products are out of GST. Hence, the amount of GST that petroleum companies pay on the hiring of rigs and purchase of equipment and services for crude oil production and refining cannot be offset against the tax paid on the final products (as petroleum products are out of GST and will continue to be covered by central excise duty and VAT). The resultant increase in cost for these industries could pose an inflationary threat. GST will result in some non-productive expenses like logistics and warehousing cost going down. This is because taxes on interstate movement like entry tax and CST will be subsumed under GST. However, this cost

reduction by the producers many not necessarily be passed on to the consumers in terms of lower prices in the near-term. As far as the direct tax impact on CPI basket is concerned, GST may not be a significant threat on inflation. For food & beverages (which has a high weight of 46% in the CPI index), prices are expected to come down due to lower GST rates. Housing (weight of 10%, includes rental on residential property) are exempted from the GST rate. Hence, there will be no impact of GST. The miscellaneous category in the CPI (28% weight) mainly covers services like health, education, transportation, etc. For most services, as discussed earlier, the tax rate is increasing from 15% to 18%. Health continues to be exempted under GST. It is to be noted that while pri-

mary and secondary education is exempted, higher private education is not exempted from GST. Overall, tax rates on 40% of items in the CPI basket will remain unchanged. The tax rate will come down for 22% of the items and will go up for only 13% of the items in the CPI basket.

International experience shows varied impact in different countries. In countries such as Australia, Canada, Japan, China and Singapore, there was an increase in inflation post-GST implementation. However, other countries like New Zealand, Greece, Portugal, Thailand, and Vietnam saw inflation reducing with the implementation of GST. However, in the case of New Zealand, inflation increased in the subsequent year of the GST implementation.

Coming back to India, while the CPI basket does not show an adverse impact of GST on inflation, we must not ignore the fact that tax on services, which is a big chunk of our GDP, is increasing. Moreover, a large part of the economy (items like petrol, diesel) are outside the ambit of GST. That may also have an inflation distortionary impact as an offset on these items will not be available under GST. In the short-term, it may not be easy to pass on the reduction in cost due to GST. Overall, we feel GST impact on inflation could be somewhere between neutral to a marginal increase in the short-term. In the medium to long-term, GST should put downward pressure on inflation through efficiency gains, reduction in supply chain rigidities and lower transportation cost.