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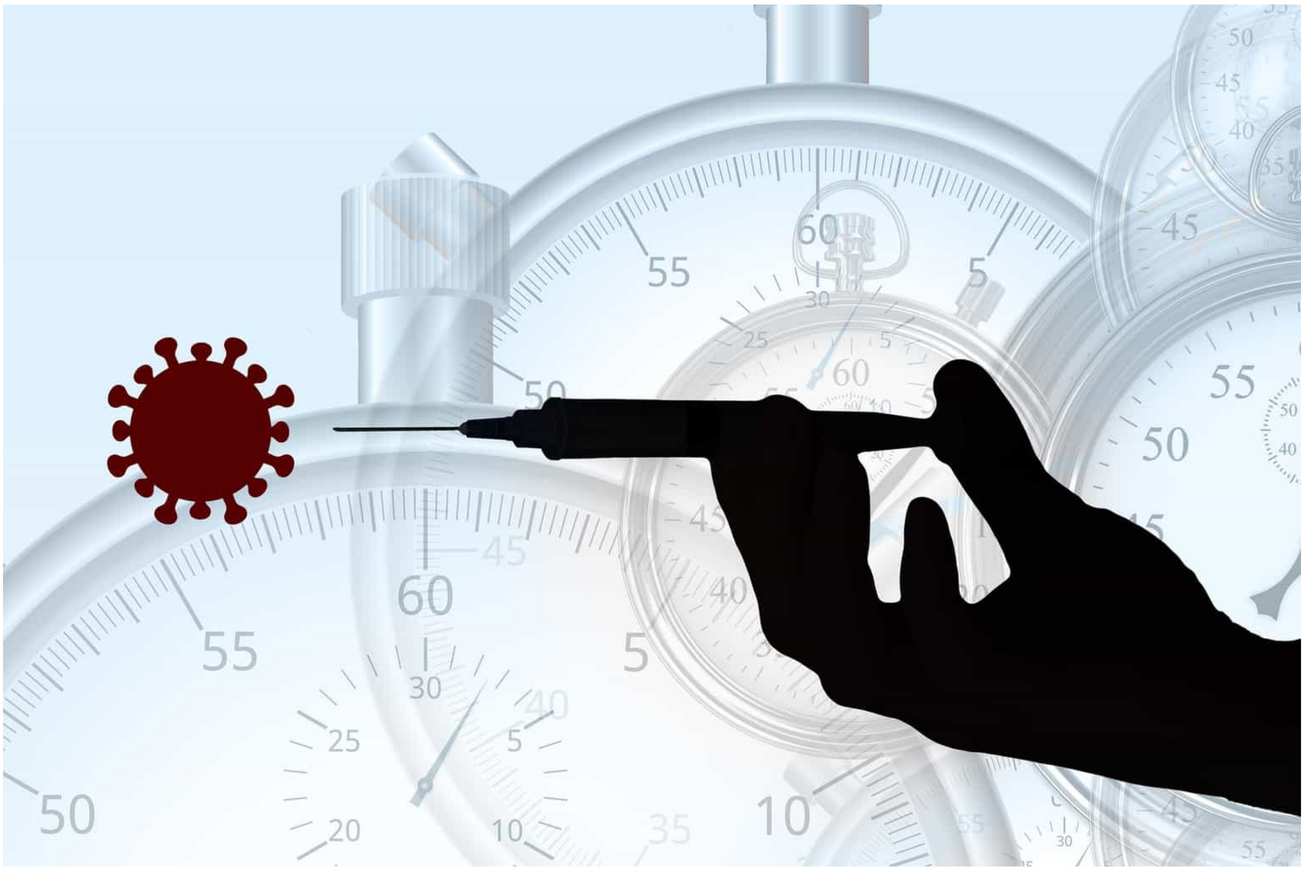
27 April, 2021

# Of Money Printing and Covid Vaccines




I recently wrote a piece for livemint.com , explaining why the central government should ensure that free vaccination against covid is available even for those in the 18-45 age bracket, and why the principles of free market do not work in this case.

In this piece, I carry the argument forward.

One of the arguments being made is that the companies making the vaccines should be allowed to price the vaccine at a price they deem to be appropriate because they need to be compensated for the risk that they are taking on.

In a normal situation, I would completely agree with that. But this is not a normal situation. We are in the midst of a health emergency of a kind India has not seen in a long time. Also, more than that, allowing companies to decide on the price of the vaccine is bad economics. (I had explained this in the livemint piece and I make a new point here).

Let me explain. There are two companies which are supplying vaccines, Serum Institute and Bharat Biotech. They have access to the entire Indian market for the next few months, before the foreign competitors come along. Of this, Serum Institute has been supplying 90% of the vaccines up until now. Basically, it has more or less got a monopoly over the Indian market.

This is a very important point that needs to be taken into account. As per India Ratings and Research 84.19 crore out of a total population of 133.26 crore are now eligible for the vaccine, basically people over the age of 18. This is something that the central government needs to keep in mind.

Even if these companies made Rs 100-150 per dose of the vaccine, there is a lot of money to be made, running into thousands of crore, and that is an adequate compensation for the risk involved. Also, it is worth remembering that Serum Institute did not develop the vaccine. It is a contract manufacturer. These points cannot be ignored.

Other than letting the vaccine companies decide on a price, the central government has also decided to let state governments procure vaccines directly from these companies. The price fixed for the state governments by the Serum Institute is Rs 400 per dose. Bharat Biotech has priced it at Rs 600 per dose.

For the private hospitals, the price has been fixed at Rs 600 per dose and Rs 1,200 per dose, respectively. Of course, these are wholesale prices, and the price eventually charged in the private hospitals, will be higher than this, as those entities need to take their costs of administering the vaccine into account and make a profit as well.

Over and above this, central government will continue to buy vaccines from these two companies and continue supplying them to state governments for free, so that those over the age of 45, can continue to be vaccinated for free, at government vaccination centres.

What will this do? Multiple price points for the vaccines in the midst of a health emergency is bad strategy to say the least. It will encourage black marketing, with black marketers sourcing vaccines from the cheapest source (central government supplying to state governments for free) and selling it for a higher price in the open market. This, especially at a time when there is a shortage of vaccines.

Hence, it makes sense that central government continue to buy the vaccines from the manufacturers and allocate it to the state governments. This does not mean that the private hospitals should not be involved in the vaccination effort. They should be because the aim is to vaccinate as many people as fast as possible.

But at the same time it needed to be ensured that the government vaccination centres vaccinated everyone for free, and not just those over 45. This would have ensured that the private hospitals could not have charged a very high amount to vaccinate. This would have keep prices in control and those who wanted to pay could have paid for the vaccine, as well.

Many state governments have declared that they will vaccinate those in the 18-45 age group, for free. While this is a good move, it needs to be said that this is something that should have happened at the central government level. The central government has many more ways of raising money than a state government. Also, the central government had allocated Rs 35,000 crore towards vaccination in the budget, with a promise to raise the allocation if required.

Over and above this, there is a more important point. But before I explain that. Let me deviate a little here and talk about an Irish-French economist called Richard Cantillon, who lived in the seventeenth century. Cantillon came up with something known as the Cantillon effect.

He made this observation based on all the gold and silver coming into Spain from what was then called the New World (now South America). When money supply increased in the form of gold and silver, it would first benefit the people associated with the mining industry, that is, the owners of the mines, the adventurers who went looking for gold and silver, the smelters, the refiners, and the workers at the gold and silver mines.

These individuals would end up with a greater amount of gold and silver, that is, money. They would spend this money and thus drive up the prices of meat, wine, wool, wheat, etc. Of course, everyone in the economy had to pay these higher prices.

How is this relevant in the world that we live in?

When central banks print money as they have been doing regularly since 2008, in order to drive down interest rates, they do so with the belief that money is neutral. So, in that sense, it does not really matter who is closer to this money being printed and who is not. But that’s not how it works.

The Cantillon effect has played out since 2008. When central banks printed and pumped money into the financial system, the large institutional investors, were the ones closest to the money being printed.

They borrowed money at cheap rates and invested across large parts across the world, fuelling stock market and bond market rallies primarily, and a few real estate ones as well.

The larger point being that if a central bank prints money and throws it from a helicopter, those standing under the helicopter, get *access* to this money first.

The important word here is *access* . With state governments and private hospitals being allowed to buy vaccines directly from the two companies, access becomes very important. When vaccination for those between 18-45 opens up on May 1, demand will go through the roof. But the supply will not go up at the same speed, with companies taking some time to scale up. So, how will the vaccine companies decide who to sell how much to?

Should they fulfil the demands of state X first or should they sell more to state Y? Or should they sell more to private hospitals, because the price is higher in that case. In this scenario, access becomes very important. This is the Cantillon effect of vaccines. The phones of the CEOs and the top management of these two companies won't stop buzzing in the months to come.

What will also happen is that many corporates will look to vaccinate their workforces (in fact, they already are), so that everyone can get back to work fast (Please remember everyone can't work from home. India has large banks and many service businesses, in which people can't work from home). In this scenario, private hospitals will have to decide whether they should vaccinate individuals or should they vaccinate corporate work forces, first.

Corporates might decide to pay a higher price for vaccination simply because it might be more profitable for them to have a vaccinated workforce going out there and doing their work, than not.

The current structure of vaccination at multiple price points makes the issue of access to vaccination very important and that shouldn't be the case. The central government should be propagating inequality even in access to vaccines.

Hence, the central government should have bought vaccines directly from the manufacturers and supplied it to the states.

Nevertheless, this is not going to happen simply because that would mean that the strategy of multiple price points was a mistake. And the government doesn't make mistakes, especially even when it makes them.

27 April, 2021

# कोरोना काल में छोटू बाबू की बड़ी शादी

शाम के पौने सात बजे थे. बिजली कटी हुई थी. पूरी गली में अँधेरा छाया हुआ था.

पर प्रोफेसर पी के श्रीवास्तव का घर दूधिया रोशनी में समझो नहा सा रहा था. उनके बड़े बेटे छोटू की शादी थी.

अमूमन तो छोटे बेटे का नाम छोटू रखा जाता है. पर यहां हुआ ऐसा था कि जब छोटू पैदा हुआ तो वो इतना छोटा था कि लोगों ने उसका नाम छोटू रख दिया. भाई मोहल्ले का भी कुछ हक़ तो बनता ही था प्रोफेसर साहब पर.

खैर फ़िलहाल छोटू को रहने दीजिये, काम की बात करते हैं.

पूरी गली में अँधेरा था तो प्रोफेसर सब घर टिमटिमा कैसे रहा था? उसके लिए आपको प्रोफेसर साहब के छोटे साले लल्लन को धन्यवाद देना पड़ेगा. लल्लन जी ने पीछे के फेज से बिजली खींच ली थी. अगर बिजली खींचने में कोई यूनिवर्सिटी पीएचडी वगैरह देती है तो लल्लन को तो ज़रूर मिलना चाहिए.

"बहुत बढ़िया बिजली खींचे हो लल्लन," प्रोफेसर साहब ने लल्लन से कहा.

लल्लन ने इसका जवाब अजीब तरह से मुस्कुरा के दिया. ये वैसी ही मुस्कराहट थी जो मिडिल एज्ड भारतीय आदमियों में अक्सर पायी जाती है, जब वो कुछ कहना चाहते हैं पर कह नहीं पाते हैं.

"क्या हुआ?" प्रोफेसर साहब ने पुछा. वो समझ गए कि लल्लन कुछ कहना चाह रहा है.

"जीजाजी वो व्यवस्था हो गयी है ना?" लल्लन ने एकदम लजा लजा के पुछा, जैसे की किसी की शादी में पहली बार दारु पीने वाले हों.

"हाँ, आखरी वाली कार में सब रखवा दिया है. ओल्ड मोंक, वैट 69, सब कुछ."

"और चखना वगैरह?"

"उसका भी बंदोबस्त हो गया है. समधी जी को गाडी का नंबर दे दिया है. जैसे ही हम लोग बरातघर पहुंचेंगे, सेवा शुरू हो जाएगी. चिल्ली चिकन वगैरह सब."

इससे पहले की लल्लन कुछ कह पाते, कमरे में, छोटू, बड़े ही गुस्सैल मूड में घुसा.

अब थोड़ा सा आपको दूल्हे राजा के बारे में भी बता दे.

छोटू दिल्ली यूनिवर्सिटी से पढ़े थे. पिताजी का बहुत अरमान था कि आईएएस अफसर बने. दो एटेम्पट दे चुके थे. दूसरी बार mains भी क्लीयर हुआ था. इंटरव्यू में वो थोड़ा लड़खड़ा गए थे. पैनल में दो लेडीज़ थी और उनके सामने छोटू जी ने एकदम चुप्पी साध ली थी.

खैर, mains क्लीयर करने के बाद, पूरे मोहल्ले में उनका बहुत नाम हो गया था. लोग छठवीं-सातवीं के बच्चों को लेकर छोटू के पास करियर एडवाइस मांगने आते थे.

इन सब चीज़ों से ज़्यादा मैरिज मार्किट में छोटू का वैल्यू बहुत बढ़ गया था. इस साल mains क्लीयर अगले साल कलेक्टर भी बनेगा, पंडित ये बोल बोल कर रिश्ते फिक्स करने की कोशिश कर रहा था.

प्रोफेसर साहब ने ये सोचा की अभी छोटू का वैल्यू ऊपर है, इसलिए उसे भंजा लेना चाहिए. क्या पता कलेक्टर बने या न बने? प्रोफेसर साहब ने तो शहर के सबसे बड़े आईएएस कोचिंग सेंटर वाले से भी बात कर रखी थी. अगर तीसरा एटेम्पट भी बेकार गया तो छोटू को वहां लगवा देंगे.

और छोटू की उम्र भी हो रही थी. ऐसे तो तीस साल के थे पर सर्टिफिकेट पर 27 की उम्र थी. इसकी वजह से शादी में प्रॉब्लम भी हो गयी थी. जिस लड़की से बात चल रही थी, उसकी उम्र सर्टिफिकेट पर 28 थी. फिर बातों बातों में पता चला की लड़की असल में 29 की है और मामला सुलझ गया.

छोटू जी बहुत गरम थे.

"पापा, आप भी कौन से बैंड वाला लेकर आ गए हैं."

"क्यों, जमाल बैंड है. हमारी शादी में भी यहीं बजाया था."

इससे पहले की छोटू कुछ कह पाता लल्लन बीच में कूद पड़े.

"क्या बढ़िया बढ़िया गाना बजाता है. आज मेरी यार की शादी है. मेरी देश की धरती सोना उगले, उगले हीरे मोती…"

"सब पुराना गाना है," छोटू ने कहा.

"अरे क्या पुराना है. यही सब गाना पर तो नागिन डांस होता है. अब क्या हम लोग तुमरा शादी में नागिन डांस भी नहीं करेंगे," लल्लन ने थोड़ा गरम होकर जवाब दिया.

"पापा, पर दोस्त सब कैसे नाचेगा. वो लोग को ई सब गाना नहीं बुझायेगा."

“क्या करें फिर?” प्रोफेसर साहब ने पुछा.

“एक ठो डीजे बुला ले?”

“डीजे?” प्रोफेसर साहब थोड़ी सोच में पड़ गए. “किसको बुलाओगे?”

“अरे पीछे वाली गली मैं पुट्टुवा रहता है ना?

“कौन पुट्टु? वो जो चार बार एटेम्पट दिया?”

“हाँ वही पापा।”

“डीजे बन गया है आजकल वो?”

“हाँ पापा, बहुत जोरदार बजाता है. डीजे वाले बाबू मेरा गाना चला दे. डीजे वाले बाबू मेरा गाना चला दे.”

“अच्छा बुला लो.”

प्रोफेसर साहब की इतनी कहने कि देर थी और छोटू उछलते कूदते हुए कमरे से बाहर निकल गया.

उसके निकलते ही प्रोफेसर साहब ने लल्लन से कहा: “जाओ देखो तुम्हारी दीदी तैयार है कि नहीं.”

“हाँ जीजाजी,” कहकर लल्लन कमरे से निकल गया.

प्रोफेसर साहब ने अपना मोबाइल फ़ोन निकाला और समधी को फ़ोन लगाया.

“बस आपका ही इंतज़ार कर रहे हैं,” समधी जी ने जवाब दिया.

“अच्छा, थोड़ी सी समस्या हो गयी है.”

“क्या समस्या?” समधी जी ने घबरा कर पुछा, आखिर लड़की की शादी का मामला था.

“अरे छोटू बाबू को अब डीजे भी चाहिए.”

“तो इस में क्या है. बुला लीजिये. एक ही बार तो हमारी बेटी से शादी करेगा. तो थोड़ा नाच गाना तो होगा ही.”

“धन्यवाद्,” प्रोफेसर साहब ने जवाब दिया.

“अरे आपका बेटा हमारा बेटा।”

“हम लोग एक घंटे में पहुँच जाएंगे,” ये कहकर प्रोफेसर साहब ने फ़ोन काट दिया.

प्रोफेसर साहब का फ़ोन काटते ही समधी जी उठे और अपनी पत्नी को खोजते हुए निकले.

“अरे रश्मी, खाने का 50 प्लेट और कम करना पड़ेगा.”

“काहे?” पत्नी ने थोड़ा इर्रिटेट होकर पुछा.

“छोटू बाबू को डीजे चाहिए.”

“ओह.”

“भाई हम आरबीआई में केवल क्लर्क थे, नोट छापने की मशीन आरबीआई के पास है हमारे पास नहीं.”

आधे घंटे बाद.

छोटू की बारात रोड पर है बरातघर की तरफ, कछुए की रफ़्तार से बढ़ रही है.

डीजे वाले बाबू तेरा गाना चला दे, बार बार बज रहा है. एक बार डीजे बजा रहा है. एक बार जमाल बैंड. दोनों में प्रतिस्पर्धा चल रही है.

लल्लन नागिन डांस करने में लगे हुए हैं. पर तोंद इतने निकल गयी है कि कम्बख्त हाथ ज़मीन नहीं छू पा रहे हैं.

इतने में धमाका टीवी के रिपोर्टर राजू जो वहां से गुज़र रहे हैं, बारात में इतने सारे लोग देख कर चकित रह गए हैं. कोरोना काल में सरकार ने बारात में परमिशन तो केवल 50 लोगों की दी है. पर यहाँ तो कम से कम 200 लोग चल रहे हैं.

रिपोर्टर राजू माइक लेकर अपने कैमरामैन के साथ जल्दी जल्दी दूल्हे के घोड़े की तरफ भागे.

छोटू टीवी रिपोर्टर को देखकर बहुत खुश होता है, घोड़े से नीचे उतरता है उससे बात करने के लिए.

“कितने लोगों का बारात है?” रिपोर्टर राजू पूछता है.

“अब सर, डेढ़ दू सौ लोग तो जइबे करेगा न बरात में,” मुँह में गुटका दबाये हुए, छोटू जवाब देता है.

“और अगर इसकी वजह से कोरोना फैल गया तो कौन ज़िम्मेवार होगा?” रिपोर्टर राजू पूछता है.

“कोरोना वरोना कुछ नहीं है.”

“मतलब?”

“अरे होता तो इतना बड़ा बड़ा रैली करते नेताजी.”

“एह?”

“और हम अंग्रज़ी अखबार पढ़ते हैं. अभी अभी इंडियन एक्सप्रेस में भल्ला और भसीन ने लिखा कि रैली से कोरोना नहीं फैलता है.”

राजू का सर घूमने लगा.

“जब रैली से कोरोना नहीं फैलता है तो बारात से कैसे फैलेगा?”

राजू का सर और भी घूमने लगा.

“सब पप्पू का साज़िश है. वही फैला रहा है ये सब नेगेटिविटी. ज़रा पॉजिटिव बात कीजिये सब अच्छा होगा.”

राजू का सर पूरी तरह से घूम जाता है और अपने कैमरामैन से कहता है: “ज़रा माइक धरो.”

और इसके बाद वो छोटू को पीटने लगता है.

बारात नाचने में मस्त है, जैसी की शादी न हो मैय्यत में आये हो, और सब के सब लगाए हुए हों.

जब तक बारात को समझ आता है क्या हो रहा है, लाइव टीवी पर छोटू पिट चूका होता है.

इस कहानी का अंत यहाँ से इंस्पायर्ड है.

25 April, 2021

# सोचो तो दुनिया बर्बाद हो रही है. और फिर से सोचो तो कुछ नहीं हुआ.

“ये है विविध भारती. दिन के डेढ़ बजे हैं और आप सुन रहे हैं मनचाहे गीत. आज के पहले गीत को गाया है उषा मंगेशकर ने, संगीत दिया है राम लक्ष्मण ने और गीतकार है रविंद्र रावल. फिल्म है तराना.”

तभी उषा ताई ने गाना शुरू किया. “सुल्ताना, सुल्ताना, मेरा नाम है सुल्ताना, मेरे हुस्न का हर अंदाज़ मस्ताना.”

इतने में मेरा मोबाइल फ़ोन बजने लगा और मैं आजकी दुनिया में वापस आया.

चिंटू जी बहुत दिन के बाद फ़ोन कर रहे थे.

न दुआ न सलाम, सीधे सीधे पॉइंट पर आ गए: “पिताजी नहीं रहे.”

“क्या हुआ?”

“पता नहीं.”

“पता नहीं?” मैंने पुछा.

“कल तक तो ठीक हो रहे थे. आज सुबह सुबह अस्पताल से फ़ोन आया.”

“हम्म,” मैं कुछ और नहीं कह पाया.”

“अकेले थे अस्पताल में. मैं यहाँ फसा हुआ हूँ और भैया अलग अस्पताल में भर्ती हैं.”

“तो फिर?” मैंने पूछा.

वो समझ गए मैं क्या पूछ रहा था और सीधा सटीक जवाब दिया: “भैया के साले साहब ने अंतिमसंस्कार करवाया. उनका अभी अभी फ़ोन आया था.”

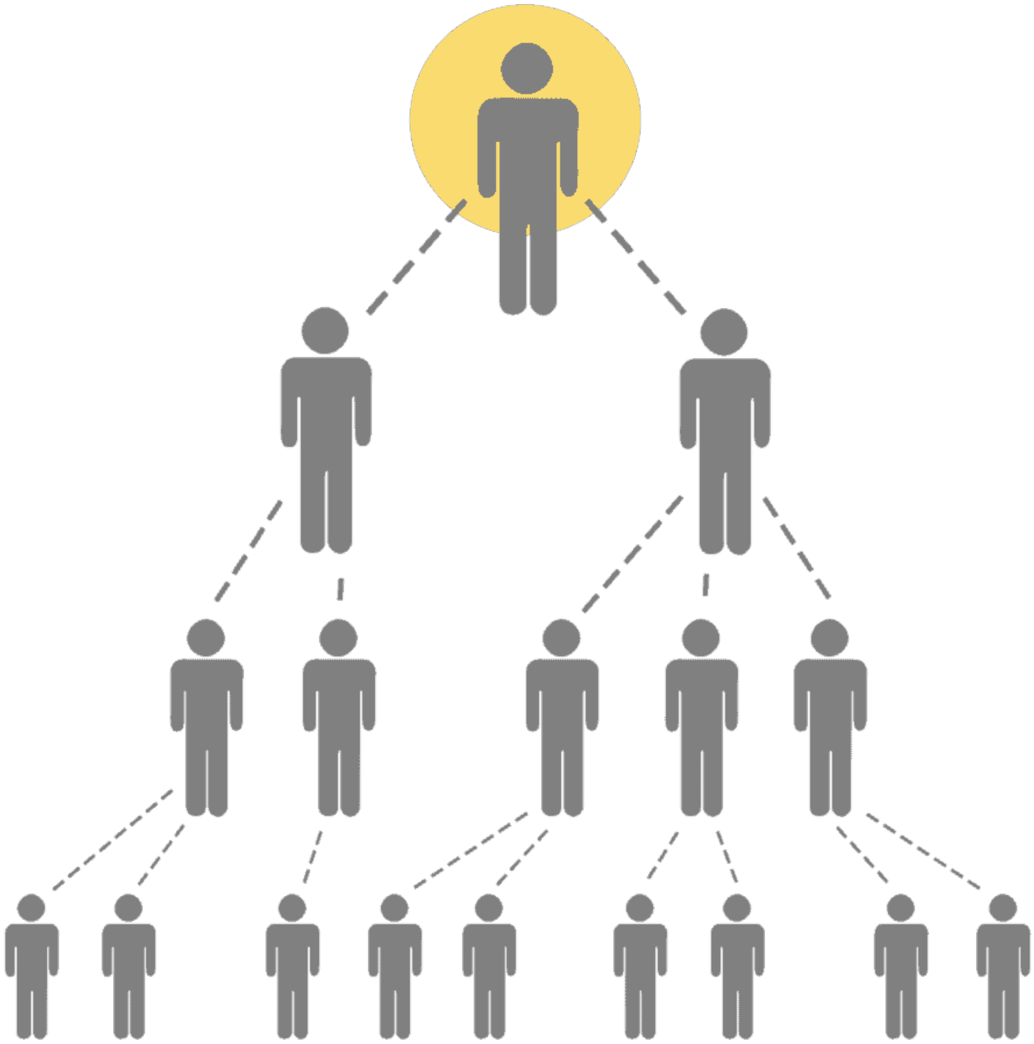
“अच्छा.”

“लाइन लगी थी इलेक्ट्रिक क्रेमाटोरियम में. बाइसवी बॉडी थी पिताजी की.”

“हम्म.”
“साले साहब बहुत ही बुरी स्थिति में है. फूट फूट कर रो रहे थे फ़ोन पर.”
“बहुत शॉक लगा होगा.”
“बड़ी मुश्किल से चुप कराया.”
“अच्छा.”
“सोचा था, बाहर जाऊँगा. थोड़े पैसे कमाऊंगा और माँ बाप को खुश रखूँगा. सब गड़बड़ हो गया. पिताजी अंत में अकेले रह गए और मैं उनको आखिरी बार भी नहीं देख पाया.”
“हम्म्म.”
“अच्छा रखता हूँ. भैया का फ़ोन आ रहा है.”
फ़ोन रखते ही. अमेज़न म्यूजिक पर उषा ताई ने आगे का गाना शुरू किया, एकदम फकीरी अंदाज़ में: “मैं आज यहाँ, कल जाने कहाँ. बंजारों का कब कोई ठिकाना. सुल्ताना, सुल्ताना, मेरा नाम है सुल्ताना, मेरे हुस्न का हर अंदाज़ मस्ताना.”
बायें वाले फ्लैट में कोई मन की बात सुन रहा था.
नीचे वाले फ्लैट में प्रेशर कुकर बार बार सीटी दे रहा था. लगता है, हर रविवार की तरह आज फिर मटन पक रहा था.
बाहर बरामदे में, मेरे दायें वाले फ्लैट के बाप और बेटा क्रिकेट खेल रहे थे.
“शार्ट पिच बोलिंग मत डाल,” बाप ने बेटे से कहा.
“अरे पर बुमराह आईपीएल में ऐसे ही डालता है,” बेटे ने जवाब दिया.
क्रिकेट के साथ साथ, एक छोटी लड़की अपनी साइकल को धीरे धीरे बरामदे में चला रही थी.
नीचे रोड पर कोई पानी की कई बाल्टियां, जो एक लकड़ी के फट्टे पर लदी हुई थी, जिसके नीचे चक्के लगे थे, घसीट कर ले जा रहा था.
रोड के सामने वर्ली बस स्टैंड में लाउडस्पीकर पर अनाउंसमेंट चालू थी और बसें आ जा रही थी.
सोचो तो दुनिया बर्बाद हो रही है. और फिर से सोचो तो कुछ नहीं हुआ.
गाना बदल चुका था.
उषा ताई जा चुकी थी. हेमलता आ गयी थी.
“ये आसमान ये बादल ये रास्ते ये हवा,
हर एक चीज़ है अपनी जगह ठिकाने से.”
जो भी कहा जा सकता था, निदा फ़ाज़ली कह गए थे.
“ये ज़िन्दगी है सफर,
तू सफर की मंज़िल है.”

20 April, 2021

# Charles Ponzi and Bernie Madoff Would Have Been Proud of the Ponzi Schemes of 2021



Bernie Madoff, the man who ran the biggest Ponzi scheme of all time, died in jail on April 14, 2021, fifteen days shy of turning 83.

A Ponzi scheme is a fraudulent investment scheme in which older investors are paid by using money being brought in by newer ones. It keeps running until the money being brought in by the newer investors is greater than the money being paid to the older ones. Once this reverses, the scheme collapses . Or the scamster running the scheme, runs away with the money before the scheme collapses.

The scheme is named after an Italian American, Charles Ponzi, who tried running such an investment scheme in Boston, United States, in 1920. He had promised to double investors' money in 90 days, which meant an annual return of 1500%. At its peak, 40,000 investors had invested $15 million in Ponzi's scheme.

Not surprisingly, the scheme collapsed in less than a year's time, under its own weight. All Ponzi was doing was taking money from newer investors and paying off the older ones.

Once *Boston Post* ran a story exposing his scheme in July 1920, many investors demanded their money back and Ponzi's Ponzi scheme simply collapsed, as money being brought in by newer investors dried up, while older investors had to be paid.

Madoff was smarter that way. His scheme gave consistent returns of around 10% per year, year on year. The fact that Madoff promised reasonable returns, helped him keep running his Ponzi scheme for decades. But when the financial crisis of 2008 struck, it became difficult for him to carry on with the pretence and the scheme collapsed.

As I wrote in a piece for the Mint newspaper yesterday, Madoff was Ponzi's most successful disciple ever. While Ponzi's investment scheme started in December 1919, it collapsed in less than a year's time in August 1920. On the other hand, documents suggest that Madoff's scheme started sometime in the 1960s and ran for close to five decades.

Nevertheless, both Madoff and Ponzi, would have been proud of the Ponzi schemes of 2021. The only difference being that the current day Ponzi schemes are what economist Nobel Prize winning Robert Shiller calls *naturally occurring Ponzi schemes* and not fraudulent ones like the kind Ponzi and Madoff ran.

A conventional Ponzi scheme has a fraudulent manager at the centre of it all and the intention is to defraud investors and take the money and run before the scheme collapses. A naturally occurring Ponzi scheme is slightly different to that extent.

Shiller defines naturally occurring Ponzi schemes in his book *Irrational Exuberance:*

> *"Ponzi schemes do arise from time to time without the contrivance of a fraudulent manager. Even if there is no manipulator fabricating false stories and deliberately deceiving investors in the aggregate stock market, tales about the market are everywhere. When prices go up a number of times, investors are rewarded sequentially by price movements in these markets just as they are in Ponzi schemes. There are still many people (indeed, the stock brokerage and mutual fund industries as a whole) who benefit from telling stories that suggest that the markets will go up further. There is no reason for these stories to be fraudulent; they need to only emphasize the positive news and give less emphasis to the negative."*

Basically, what Shiller is saying here is that the stock markets enter a phase at various points of time, where stock prices go up simply because new money keeps coming in and not because of the expectations of earnings of companies going up in the days to come.

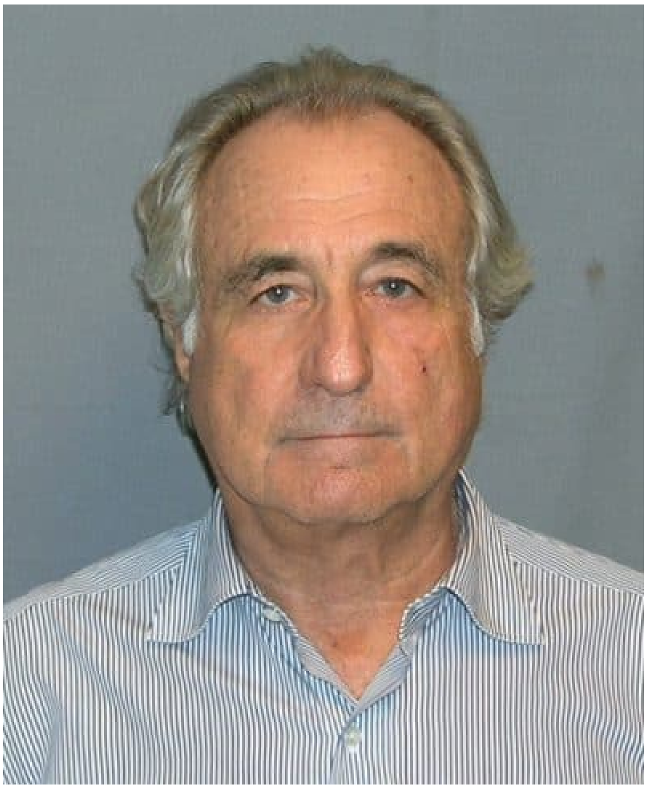
Ultimately, stock prices should reflect a discounted value of future company earnings. But quite often that is not the case and the price goes totally out of whack, for considerably long periods of time.

A lot of money comes in simply because the smarter investors know that newer money will keep coming in and stock prices will keep going up, and thus, stocks can be unloaded on to the newer investors. Hence, like in a Ponzi scheme, the money being brought in by the newer investors pays off the older ones. In simpler terms, this can be referred to as the greater fool theory.

The investors buying stocks at a certain point of time, when stock prices do not justify the expected future earnings, know that greater fools can be expected to invest in stocks in the time to come and to whom they can sell their stocks.

Of course, this is not the story that is sold. If you want money to keep coming into stocks, you can't call a prospective fool a fool. There is a whole setup, from stock brokerages to mutual funds to portfolio management services to insurance companies selling investment plans, which benefit from the status quo. Their incomes depend on how well the stock market continues to do.

They are the *deep state* of investment and need to keep selling stories that all is well, that stocks are not expensive, that this time is different, that a new era is here or is on its way, that stock prices will keep going up and that if you want to get rich you should invest in the stock market, to keep luring fools in and keep the legal Ponzi scheme, for the lack of a better term, going.



*— Bernie Madoff*

This is precisely what has been happening all across the world since the covid pandemic broke out. With central banks printing a humongous amount of money, interest rates are at very low levels, forcing investors to look for higher returns. A lot of this money has found its way into stock markets. The newer investors have bid stock prices up, thus benefitting the older investors. The deep state of investment has played its role.

Of course, the counterpoint to whatever I have said up until now is that unless new money comes in, how will stock prices ever go up. This is a fair point. But what needs to be understood here is that in the last one year, the total amount of money invested in stocks has turned into a flood. Take the case of foreign institutional investors investing in Indian stocks.

They net invested a total of $37.03 billion in Indian stocks in 2020-21. This was almost 23% more than what they invested in Indian stocks in the previous six years, from April 2014 to March 2020. This flood of money can be seen in stock markets all across the world.

Clearly, there is a difference, and the stock market has worked like a naturally occurring Ponzi scheme, at least over the last one year.

This Ponziness is not just limited to stocks. Take a look at what is happening to Indian startups…oh pardon me…we don't call them startups anymore, we call them unicorns, these days. A unicorn is a startup which has a valuation of greater than billion dollars.

How can a startup have a valuation of more than a billion dollars, is a question well worth asking. I try and answer this question in a piece I have written in today's edition of the Mint newspaper .

As mentioned earlier, there is too much money floating all around the world, particularly in the rich world, looking for higher returns. Venture capitalists (VCs) have access to this money and thus are picking up stakes in Indian startups at extremely high prices.

Many of these startups have revenues of a few lakhs and losses running into hundreds or thousands of crore. The losses are funded out of money invested by VCs into these unicorns.

The losses are primarily on account of selling, the service or the good that the startup is offering, at a discounted price. The idea is to show that a monopoly (or a duopoly, if there is more than one player in the same line of business) is being built in that line of business and then cash in on that through a very expensive initial public offering (IPO).

As and when, the IPO happens, a newer set of investors, including retail investors, buy into the business, at a very high price, in the hope that the company will make lots of money in the days to come. Interestingly, IPOs which used to help entrepreneurs raise capital to expand businesses, now have become exit options for VCs.

If an IPO is not possible, then the VC hopes to unload the stake on to another VC or a company and get out of the business.

In that sense, the hope is that a newer set of investors will pay off an older set, like is the case in any Ponzi scheme. Of course, this newer set then needs another newer set to keep the Ponzi going.

The good thing is that when investors buy a stock of an existing company or in a new company's IPO, they are at least buying a part of an underlying business. In case of existing companies, chances are that the business is profitable. In case of an IPO, the business may already be profitable or is expected to be profitable.

But the same cannot be said about many digital assets that are being frantically bought and sold these days. There is no underlying business or asset, for which money is being paid. Take the case of Dogecoin which was created as a satire on cryptocurrencies.

As I write this, it has given a return of 24% in the last 24 hours. An Indian fixed deposit investor will take more than four years to earn that kind of return and that too if he doesn't pay any tax on the interest earned.

Why is Dogecoin delivering such fantastic returns? As James Surowiecki writes in a column : "There is no good answer to that question, other than to say Dogecoins have gotten dramatically more valuable because people have decided to act as if they're more valuable."

As John Maynard Keynes puts it, investors are currently anticipating "what average opinion expects the average opinion to be." Carried away by the high returns on Dogecoin, the expectation is that newer investors will keep investing in it and hence, prices will keep going up. The newer investors will keep paying the older ones. That is the hope, like is the case with any Ponzi scheme, except for the fact that in this case, there is no fraudulent manager at the centre of it all.

Of course, the only way the value of Dogecoin and many other cryptocurrencies can be sustained, is if newer investors keep coming in and at the same time, people who already own these cryptocurrencies don't rush out all at once to cash in on their gains.

If this does not happen, as is the case with any Ponzi scheme, when existing investors demand their money back and not enough newer investors are coming in, this Ponzi scheme will also collapse.

*– – Charles Ponzi*

Given this, like is the case with people who are heavily invested in stocks, it is important for people who are heavily invested in cryptos to keep defending them. Of course, a lot of times this is technical mumbo jumbo, which basically amounts to that old phrase, *this time is different.*

But *this time is different* is probably the oldest lie in finance. It rarely is.

And if dogecoin was not enough, we now have investors going crazy about non-fungible tokens (NFTs), which in simple terms is basically certified digital art. As Jazmin Goodwin points out: "For example, Jack Dorsey's first tweet is now bidding for $2.5 million , a video clip of a LeBron James slam dunk sold for over $200,000 and a decade-old "Nyan Cat" GIF went for $600,000 ." The auction house Christie sold its first ever NFT artwork for $69 million, in March.

In a world of extremely low interest rates and massive amount of printing carried out by central banks, there is too much money going around chasing returns.

There aren't enough avenues and which is why we have financial and digital assets now turning into naturally occurring Ponzi schemes, giving the kind of returns that the original Ponzi scamsters, like Ponzi himself and his disciple Madoff, would be proud off.

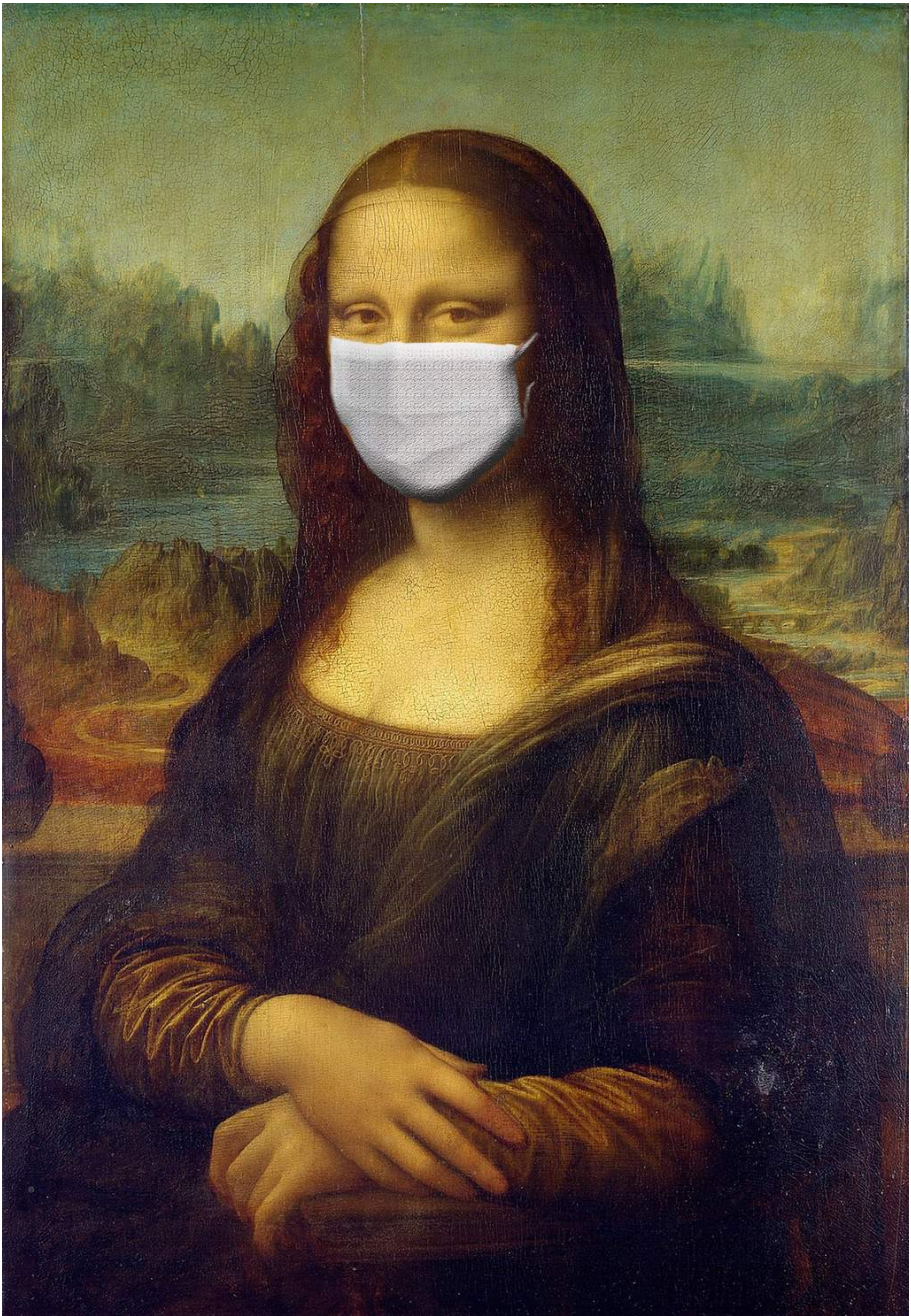
Madoff's scheme delivered returns of 10% returns per year. Ponzi promised to double investors' money in three months or a return of 100% over three months. As I write this, Dogecoin has given a return of more than 600% over the last one month.

Here's is how the price chart of Dogecoin looks like over the last one month.


Source: https://www.coindesk.com/price/dogecoin .

17 April, 2021

# शर्मा जी, वर्मा जी एंड द रिटर्न ऑफ़ कोरोना



सुबह के साढ़े पांच पौने छे बजे थे. सूरज धीरे धीरे निकलने का प्रयत्न कर रहा था.

वर्मा जी अपने घर के बगान में गरम पानी लेकर कुर्सी पर अभी अभी बैठे थे. गरम पानी मोशन सुधारने के लिए नहीं था. उसमें वर्मा जी ग्रीन टी का एक बैग डुबोने वाले थे.

twinings ग्रीन टि का बड़ा डब्बा दो दिन पहले छोटी बहु ने अमेज़न से भिजवाया था.

"पापा आपकी तोंद फिर से निकल आयी है," बड़े प्यार से वो बोली थी. "थोड़ा सुबह उठकर ग्रीन टी पीजिये."

इस पर मिसेज वर्मा खिसिया कर बोली: "हाँ, अब तो आप हमारे हाथ की बनी चाय भी नहीं पियेंगे." पहले तो केवल बेटे को खो देने का गम था. अब पति भी हाथ से निकला जा रहा था.

इतने में शर्मा जी अपने घर से पूरी तरह तैयार हो कर सुबह की सैर करने के लिए निकले. और जब लोग मुँह पर दो दो मास्क लगा रहे हैं, उन्होंने ने एक भी लगाने की गुंजाईश नहीं की थी.

"अरे शर्मा जी मास्क तो लगा लीजिये," वर्मा जी ने पुकारा.

"भाई हम दो दिन पहले ही गंगा जी में डुबकी लगाए हैं," शर्मा जी ने जवाब दिया.

"अच्छा तब तो ठीक है."

"हाँ."

"वैसे भी मिश्रा जी अभी दो दिन पहले…"

"कौन वाला मिश्रा, पान वाला या गुटका वाला?" शर्मा जी ने पुछा.

"पान वाला."

"हाँ फिर ठीक है."

"क्यों?" वर्मा जी ने पुछा.

"अरे ऊ गुटका वाला बहुत थूकता है हर जगह."

"अब का करेगा, गुटका का पीक मुंह में थोड़े रखा रहेगा."

"छोड़िये. आप क्या कह रहे थे?" शर्मा जी ने पुछा.

"हाँ तो मिश्रा जी एक ठो फॉरवर्ड भेजे थे व्हाट्सप्प पर."

"अच्छा."

"उसमें ऐसा लिखा था कि, ऑक्सफ़ोर्ड यूनिवर्सिटी में रिसर्च हुआ है…"

"अब ऑक्सफ़ोर्ड यूनिवर्सिटी में रिसर्च नहीं होगा तो का रांची यूनिवर्सिटी में होगा?" शर्मा जी ने टोका और फिर अपने ही चुटकुले पर ज़ोर ज़ोर से हसने लगा. "आप भी न वर्मा जी."

"अरे आप बोलने तो दीजिये."

"अच्छा, बोलिये बोलिये."

"तो ऑक्सफ़ोर्ड यूनिवर्सिटी में एक ठो रिसर्च हुआ है. उसमें ये पाया गया कि गंगा जी में डुबकी लगाने से बॉडी में ऐसा ऐसा मिनरल आ जाता है, जिससे कोरोना पास भी नहीं आता है, दुरे से निकल लेता है."

"हम तो बोल ही रहे थे," शर्मा जी ने कहा.

"हाँ, पर फिर भी लगा लीजिये, नहीं तो ठोलवा सब पकड़ लेगा."

"इतना सुबह सुबह?"

"हे हे."

"ऐसे मिशरवा हमको भी एक फॉरवर्ड भेजा था," शर्मा जी ने कहा.

"पान वाला या गुटका वाला?"

"गुटका वाला।"

"गुटका वाला?"

"हाँ थूकता बहुत हैं, पर फॉरवर्ड अच्छा भेजता हैं."

"हमको तो नहीं भेजता है."

"अरे, आप टेलीग्राम पर हैये नहीं है की."

"टेलीग्राम? ऊ तो कितने साल से बंद हो गया नहीं?" वर्मा जी ने एकदम आश्चर्यचकित हो कर कहा.

“अरे, वो वाला नहीं.”

“तो फिर कौन वाला.”

“अभी अभी व्हाट्सप्प जैसा आया है.”

“व्हाट्सप्प जैसा टेलीग्राम?” वर्मा जी के पल्ले नहीं पड़ रहा था कि शर्मा जी क्या बोल रहे थे.

“आपके यहाँ कपडा कौन वाशिंग पाउडर में धुलता है?”

“मिसेज़ को तो सर्फ एक्सेल पसंद है. पर बहुत महंगा पड़ता है, इसलिए थोड़ा रिन के साथ मिला देते हैं.”

“हमारी मिसेज़ को अरियल पसंद है.”

“अच्छा.”

“अब जैसे अलग अलग वाशिंग पाउडर आता है…”

“अच्छा अब समझ में आया. टेलीग्राम नया टाइप का व्हाट्सअप है,” वर्मा जी ने मुस्कुराते हुए कहा.

“हाँ.”

“तो आप क्या कह रहे थे?” वर्मा जी ने पुछा.

“तो गुटका वाला मिशरवा एक ठो फॉवर्ड भेजा,” शर्मा जी बोले.

“अच्छा.”

“उसमें ये बताया था कि कोरोना जैसा कुछ नहीं है. पूरा का पूरा एक साज़िश है,” शर्मा जी ने कहा.

“साज़िश? किसका?”

“सीआईए और बिल गेट्स का.”

“एह. हम तो सुने कि चाइनीज़ लोग चमगादड़-वमगादड़ खाकर इसको फैलाया है.”

“अरे ऊ तो पुराना न्यूज़ है. अभी सुनिए.”

“अच्छा.”

“सीआईए और बिल गेट्स, मिलकर अफवाह फैलाया है कोरोना के बारे में.”

“पर वो लोग ऐसा क्यों करेगा?”

“देखिये सीआईए का तो मालूम नहीं, पर बिल गेट्स का हम समझ सकते हैं.”

“समझ सकते हैं?” वर्मा जी ने पुछा. “कैसे?”

“अरे, अब इतना पैसा कमा लिया. माइक्रोसॉफ्ट को इतना बड़ा कंपनी बना दिया. तीन ठो बच्चा लोग भी बड़ा हो गया है उसका. घर छोड़ कर जाने के लिए तैयार है.”

“हाँ तो?” वर्मा जी के समझ में कुछ नहीं आ रहा था.

“हम लोग के यहाँ तो बच्चा लोग जब घर भी छोड़ता है, तो माँ बाप के बारे में सोचता है. दादा दादी, नाना नानी बनाता है. इसलिए हम लोग का मन लगा रहता है और समय बीतता जाता है.”

“एकदम सही बोले आप शर्मा जी,” वर्मा जी ने कहा. कल रात को ही खबर आयी थी कि उनके सबसे छोटे बेटे चिंटू और उसकी बीवी रिंटू को, इशू होने वाला है.

“पर अमरीका में इंडिया जैसा वैल्यूज नहीं न है. तो बिल गेट्सवा अब बोर हो गया है. इसलिए सीआईए के साथ मिलकर अफवाह फैला दिया कोरोना के बारे में.”

“अरे बाप रे.”

“एकदम. मिश्रा जी का फॉरवर्ड कभी गलत नहीं होता है. कोरोना जैसे कुछ नहीं है. और जो है ही नहीं वो किसी को कैसे हो सकता है.”

तभी शर्मा जी के घर के अंदर से आवाज़ आयी.

“अच्छा सुनते हैं,” मिसेज़ शर्मा बोली. “आधा दर्जन अंडा और एक डबल रोटी भी ले आइयेगा.”

“हाँ ठीक है,” शर्मा जी ने जवाब दिया.

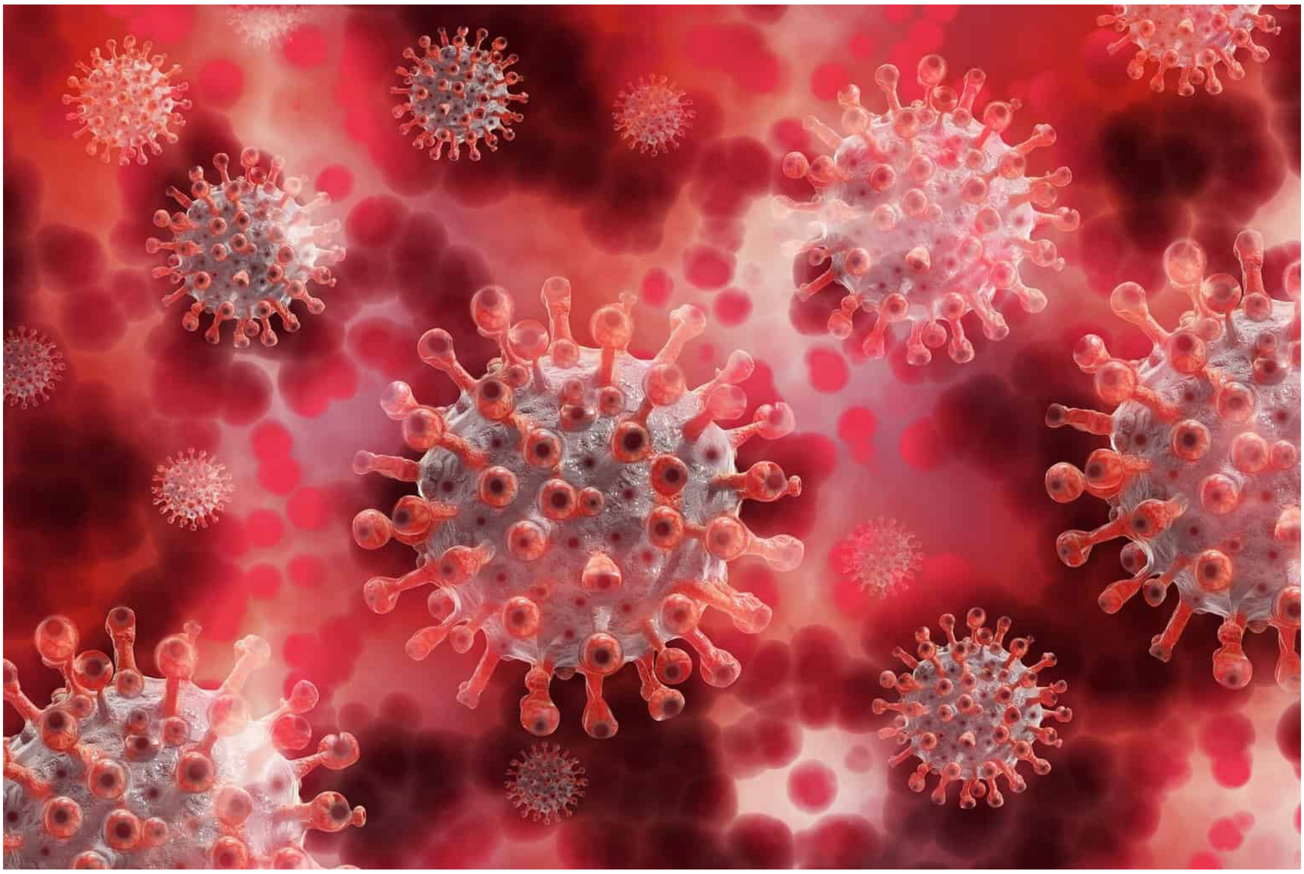
“अंडा?” वर्मा जी ने पुछा. “आप लोग अभी भी अंडा खाते हैं?”

“काहे?”

“अरे आप को कोई मेनका गाँधी का अंडे वाला फॉरवर्ड नहीं भेजा क्या आज तक व्हाट्सप्प पर.”

16 April, 2021

# मिसेज़ शर्मा, मिसेज़ वर्मा एंड द रिटर्न ऑफ़ कोरोना



शाम के छे-साढ़े छे बजे हैं. सूरज ढल चुका है. कोरोना की दूसरी वेव का प्रकोप शहर में फैल चुका है. ऐसे माहौल में, मिसेज़ शर्मा और मिसेज़ वर्मा अपने अपने घर के सामने छोटे से बगान में बैठी हुईं, सोशल डिस्टन्सिंग बनाये हुए, एक दुसरे से बातें कर रही हैं.

आईये सुनते हैं.

"और आप सूई ले लीं? मिसेज़ शर्मा ने पुछा.

"अब क्या बताएं," मिसज़ वर्मा ने जवाब दिया. "अरे परसों मिस्टर और हम गए थे. अस्पताल पहुंचे तो Compounder मिस्टर से बोलिस, आज तो ख़तम हो गया है सर."

"ख़तम, ख़तम कैसे हो गया?"

"हम भी वही बोले."

"तब तो टीका उत्सव चल रहा था न."

"हम भी वही बोले."

"मोदी जी दिन में 18 घंटे काम कर रहे हैं और ई सब compounder लोग से दू ठो सुई नहीं संभल रहा है."

"हम भी वही बोले," मिसेज़ वर्मा ये बोलकर जैसे अटक सी गयी.

"और आपका चुन्नू ठीक है?" मिसेज़ शर्मा ने पुछा.

"हाँ ठीक ही है," मिसेज़ वर्मा का जवाब आया.

"और इशू–विशु के बारे में कुछ सोचा कि नहीं?"

"अरे क्या बताएं," मिसेज़ वर्मा बोलीं.

"ऐसे अभी तो टाइम भी सही था," मिसेज़ शर्मा बोली.

“मतलब?”

“सबका वर्क फ्रॉम होम चल रहा है.”

“हाँ तो?”

“अरे आदमी घर से काम करता है तो थकता कम हैना. ज़्यादा ताकत रहता है ”

“अच्छा समझे.”

“ऐसे तुमको एक बात बोलेंगे, बुरा मत मानना.”

“अरे नहीं बोलिये, बुरा काहे मानेंगे, ” मिसेज़ वर्मा ने कहा.

“हमारी मंझली दीदी का लड़का हैना.”

“कौन बबलू?”

“हाँ. तो वो भी बहुत दिन तक इशू नहीं किया.”

“अच्छा फिर?”

“फिर क्या, दवाई का आदत लग गया. बहुत मुश्किल से हुआ.”

“अरे बाप रे.”

“इस लिए समय रहते कर लेना चाहिए,” मिसेज़ शर्मा ने कहा. “हर चीज़ का एक उम्र होता है.”

“ऐसे हम परसों ही पूछे उससे कि क्या प्लान है,” मिसेज़ वर्मा ने कहा.

“क्या बोला?”

“बोला, मम्मी ऐसी दुनिया में बच्चा लाकर क्या मतलब.”

“मतलब?”

“हम समझाये, के बेटा, बच्चा कोई मतलब के लिए थोड़े पैदा करता है. बच्चा पैदा करना होता है, इसलिए पैदा करता है.”

“अच्छा. फिर क्या बोला?” मिसेज़ शर्मा ने पूछा.

“बोला, मम्मी तुम समझ रही हो क्या बोल रही हो.”

“ओह, ऐसा बोल दिया.”

“हाँ.”

“हम तो तुमको बोले थे, जेनयू वेनयू मत भेजो. बच्चा लोग घर से बहार डॉक्टर इंजीनियर बनने के लिए निकले तो अच्छा लगता है. हिस्ट्री पढ़ने के लिए इतना मेहनत…”

“हाँ आप तो बोली थी. और हम भी मिस्टर को बोले थे. पर वो उधर से बोले, कब तक अपने पास बांध के रखोगी,” मिसेज़ वर्मा ने कहा.

“ऐ माँ, गाय है क्या जो बांध कर रखेंगे.”

“सही कहीं आप.”

“हमारी बड़ी दीदी का लड़का…”

“चिंटू?”

“हाँ. वो भी जेनयू गया था, करीब दस साल पहले.”

“अच्छा.”

“बस बंगाली लड़की से शादी कर लिया.”

“अरे बाप रे. बहुत एग्रेसिव होगी वो तो?”

“हैये है कि. कच्चा चबा गयी अपनी सास को,” मिसेज़ शर्मा ने कहा.

“दीदी और जीजाजी आपके मान कैसे गए?” मिसेज़ वर्मा ने पूछा.

“शुरू में नहीं माने थे. फिर चिंटू बोला, शादी कर रहे हैं, आना है तो आईये, नहीं तो भाड़ में जाईये.”

“बच्चा लोग के सामने आदमी मजबूर हो जाता है.”

“एकदम. हम तभी राजू को जेनयू नहीं भेजे. बोले यहीं रांची यूनिवर्सिटी में पढ़ लो.”

“एकदम ठीक की.”

“तभी मोदी जी कहते हैं, हार्डवर्क इस मोर इम्पोर्टेन्ट दैन हारवर्ड,” मिसेज़ शर्मा ने कहा.

“कहेंगे नहीं. वो तो पूरा पोलिटिकल साइंस पढ़े हैं,” मिसेज़ वर्मा ने कहा.

तभी मिसेज़ वर्मा के घर के अंदर से आवाज़ आयी. “शीला, गप मारना ख़तम करो. भूक लगी है. डिनर दे दो.”

“मिस्टर बुला रहे हैं लगता है?” मिसेज़ शर्मा ने कहा.

“हाँ.”

“पर पौने सात बजे डिनर?”

“अब क्या बताएं.”

“क्या हुआ?”

“अरे छोटी बहु बोल दी है कि पापा आपका तोंद निकल गया है. अच्छा नहीं लग रहा है.”

“ओह चुन्नू की मिसेज़ ऐसा बोल दी.”

“हाँ.”

“तो?”

“इसलिए, आजकल जल्दी खा रहे हैं…उसको का बोलते हैं.”

“इंटरमिटेंट फास्टिंग.”

“हाँ वही करने की कोशिश कर रहे हैं.”

“अच्छा.”

“इनको न हमेशा से मन था कि एक बेटी भी हो,” मिसेज़ वर्मा ने थोड़ा शर्मा के कहा. “इस लिए छोटी बहु का बात इतना ध्यान से सुनते हैं.”

“अच्छा.”

“तीन लड़का के बाद, बोले एक बार और ट्राई करते हैं, हो सकता है इस बार बेटी हो जाए.”

“अच्छा.”

“पर हम हाथ खड़ा कर दिए.”

“अच्छा.”

“बोले, और ताकत नहीं है.”

“अच्छा.”

“पहले ही तीन बच्चा संभालना…”

“शीला,” मिसेज वर्मा के घर के अंदर से फिर आवाज़ आयी.

“अच्छा तो हम चलते हैं,” मिसेज़ वर्मा ने कहा.

“फिर कब मिलयेगा?” मिसेज़ शर्मा ने पुछा.

“जब आप कहियेगा.”

“जुम्मे रात को?”

“नहीं आधी रात को.”

15 April, 2021

# Matthew Effect of Covid Pandemic: Rich Got Richer and Poor Got Poorer

In 1968, sociologists Robert K Merton and Harriet Zuckerman, came up with the concept of the Matthew Effect of accumulated advantage. The term takes its name from the Gospel of Matthew, which points out: " *For to everyone who has will more be given, and he will have abundance; but from him who has not, even what he has will be taken away* ."

In simpler terms, the Matthew Effect of accumulated advantage is stated as *the rich become richer and the poor get poorer* . This is precisely how things have played out over the last one year, as the covid pandemic has spread through India and large parts of the world.

Let's take a look at the different ways in which this has happened.

**1)** Central banks in the rich world have printed a massive amount of money post covid. Just the Federal Reserve of the United States has printed more than $3.5 trillion between end February 2020 and now. Other big central banks like the Bank of England, the Bank of Japan and European Central Bank have also done the same.

This has been done in order to drive down interest rates. The hope is that at lower interest rates people will borrow and spend money, and businesses will borrow and expand. This will help the economy revive. Many rich countries have put money directly in the bank accounts of people, encouraging them to spend.

Some of this money has found its way into stock markets all around the world, including India, driving stock prices way beyond what the earnings of companies justify. The foreign institutional investors invested a whopping $37.03 billion in Indian stocks in 2020-21, the highest they have ever invested. The next best being $25.83 billion in 2012-13.

This sent stock prices soaring with the Sensex, India's most famous stock market index, gaining 68% in 2020-21. In fact, the market capitalisation of all BSE listed stocks (not just the 30 Sensex stocks) went up by Rs 90.82 lakh crore in 2020-21.

The poor don't buy stocks, the rich do. The rally in the stock market has benefitted them tremendously, making them richer. In 2019-20, investment in shares and debentures (which includes mutual funds), despite all the hype, formed a minuscule 3.39% of the overall Indian household financial savings. In 2020-21, this would have definitely gone up, but given its low base it would have still formed a very small part of the overall financial savings of Indian households.

As per the 10th Edition of Hurun Global Rich List 2021 , India added 55 new dollar billionaires in 2020, with the total number of billionaires in the country going up to 177, a 45% jump in the number of billionaires in comparison to 2019. If one looks at the list of the richest Indian billionaires, most of their wealth is in the stock market. And with stock markets rallying big time in 2020-21, their wealth has gone up.

**2)** Like the central banks of the rich world, the Reserve Bank of India (RBI) also joined the money printing party and printed Rs 3.6 lakh crore between the beginning of March 2020 and the end of March 2021. This has primarily been done in order to drive down interest rates and help the government borrow at lower interest rates. The central government borrowed Rs 12.8 lakh crore last year and is expected to borrow Rs 12.06 lakh crore in 2021-22.

While money printing helps the central government borrow at lower rates, it hurts the middle class and the poor, who invest in fixed deposits and other forms of fixed income investments to save money. It needs to be remembered that most Indians save by investing in fixed deposits, small savings schemes, provident and pension funds and life insurance. In 2019-20, 84.24% of the household financial savings were made in these financial instruments. Low interest rates *largely* mean lower returns from these investments.

In the last two years, the average interest rate on bank term deposits (fixed deposits, recurring deposits, etc.) of more than one year has come down dramatically. It was at 7.5% in March-April 2019. In March 2021, it stands at 5.5%. A bulk of this fall has happened from the beginning of 2020. Recently, the government had majorly cut the interest rates on small savings schemes for the period April to June. Nevertheless, it reversed the decision overnight, probably because of the assembly elections that were still on. It is now expected that the government will cut the interest rate on small savings schemes for the period July to September.

Lower interest rates, hurt the middle class and the poor especially when the rate of inflation is as high as the interest rates on offer.

The money printing by the RBI to drive down interest rates is likely to continue in the months to come. The Indian central bank is expected to print Rs 1 lakh crore during April to June . This means that bank interest rates will continue to remain low, continuing to hurt the poor and the middle class.

**3)** While the Indian economy is expected to contract during 2020-21, data from Centre for Monitoring Indian Economy (CMIE) shows that the listed corporates (both financial and non-financial) have made their highest profits ever during the period July to September 2020 and October to December 2020.

As Mahesh Vyas of the Centre for Monitoring of Indian Economy pointed out in a recent piece: "In the December 2020 quarter, the net profit of listed companies exceeded…the record profits of September 2020." The net profit during the quarters stood at Rs 1.51 lakh crore and Rs 1.53 lakh crore, respectively. These were the highest quarterly profits ever made by listed Indian corporates.

This means that owners of these businesses have grown richer and so has the top management of these companies given that they own employee stock option plans and benefit from the dividends paid by the companies every year.

But how did listed Indian corporates make their highest profits ever, while the economy was contracting? The net sales of the non-financial companies, which are a bulk of the listed corporates, fell by 10.4% in the quarter ending September and by 0.9% in the quarter ending December, in comparison to a year earlier, but the companies still made record profits. This happened primarily because the companies were able to drive down their operating expenses.

In the quarter ending March 2020, the operating expenses or the cost of running a business, made up 91.1% of their sales. In the quarters ending September 2020 and December 2020, the operating expenses amounted to 81.4% and 82.8% of the sales, respectively.

In simple English, the companies slashed employee expenses and they renegotiated their contracts with their suppliers and contractors, to drive down their costs. The larger businesses benefitted in the process at the cost of the smaller ones.

Of course, if a small company gets paid a lower amount of money from a large company, it also has to renegotiate the money it is paying to its employees and suppliers. This also leads to job losses as smaller companies then need to fire employees in order to cut costs and continue to stay viable.

This has played out for the last one year and continues to play out now as well, with the second wave of covid spreading. It is not easy to put a number to this phenomenon, but that does not mean that this is not happening or is not important.

**4)** Data from the Centre of Monitoring Indian Economy shows that the size of the labour force between January 2020 and March 2021, has shrunk by 1.66 crore. This when the size of the working age population or the population greater than 15 years of age has increased by 2.88 crore during the same period.

What this means is that many individuals who can’t find jobs, have stopped looking and simply dropped out of the workforce. To be counted as a part of a labour force, an individual needs to be either employed or unemployed and be looking for a job.

The sheer size of numbers here tells us that it is the poor who are dropping out of the workforce, giving up on job search. Also as I have discussed in the past , women have faced the brunt of India’s unemployment problem.

**5)** The rise of the internet and the availability of cheap broadband has ensured that the need to have all hands on the deck is no longer there.

Of course, this does not mean that everyone can work from home. The working class has faced the brunt of the crisis. As Scott Galloway writes in *Post Corona – From Crisis to Opportunity* : "Most working-class people… can't do their jobs at home, since they are tied to the store, warehouse, factory, or other place of work."

People working in factories, hotels, bank branches, hospitals, real estate projects, mom and pop shops, emergency services, delivery services, etc., or driving cabs for that matter, need to turn up at their places of work and job sites every day.

Also, extended working from home, will end up having other major economic consequences. Other than permanent employees, every office has office maintenance jobs which are not on the rolls of the company. Most large offices have canteens run by a contractor. Some companies offer pick up and drop facilities to their employees.

This is how services companies create low-skilled and semi-skilled jobs. Around many large office complexes there are *tapris* (very small shops) selling tea, coffee and food. Further, the app cab drivers and normal taxi drivers, have already seen their business go down.

Working from home has already hit people in these professions hard. Again, while it is not easy to put a number to this phenomenon, that does not mean that this is not happening or is not important.

**6)** Given these factors, it is hardly surprising that many people have dropped out of the middle class. A Pew Research centre analysis found that "the middle class in India is estimated to have shrunk by 32 million in 2020 as a consequence of the downturn, compared with the number it may have reached absent the pandemic."

This accounted for three-fifths of the global retreat in the number of people in the global middle class (defined as people with incomes of $10.01-$20 a day).

While the number of people dropping out of the middle class is high, the increase in the number of poor is shocking beyond belief. Their number is "estimated to have increased by 75 million because of the COVID-19 recession." This also accounts for around three-fifths of the global increase in poverty.

In fact, this is something that Nobel Prize winning economist Angus Deaton confirms in a recent research paper , where he points out:

> *"China did better than almost all other countries, while India did worse. China's 1.4 billion people experienced few deaths and growth in per capita income, which took them closer to the richer countries of the world and decreased (weighted) global inequality. India's 1.4 billion people experienced many more deaths, as well as a*

> *large drop in income, which increased (weighted) global inequality."*

Of course, with the second wave of covid starting, all this is likely to continue. One point that we need to consider here is the ability of individuals to make a living in the years to come. School and college students are being taught digitally since the last one year. It needs to be considered here that not every student has access to a computer. Further, even if there is access to a computer, it might have to be shared among multiple siblings. Then there is the question of internet speed, electricity and so on.

The quality of education being delivered digitally will impact the earning capacity of many middle class and poor students, in the years to come.

In short, like the disease itself, the negative economic effects of covid, especially among the poor and the middle class, will continue to be felt in the years to come.

12 April, 2021

# Ten Things to Remember While Buying a Home

This piece emerged out of a couple of WhatsApp conversations I had over this weekend, along with a few emails that I have received over the last few months.

From these conversations and in trying to answer the emails, I have tried to develop a sort of checklist of things to keep in mind, while buying a home. Of course, as I have said in the past, when it comes to personal finance, each person's situation is unique, and which is why it's called personal finance.

Nevertheless, there are a few general principles that can be kept in mind. Also, this list like all checklists, is complete to the extent of things I can think of.

So, let this not limit your thinking and the points that you need to keep in mind.

Here we go.

**1)** If you are buying the house as an investment (not in my scheme of things, but nonetheless), please learn how to calculate the internal rate of return on an investment. Believe me, you will thank me for the rest of your life.

Also, keep track of the cost of maintaining a house and other costs that come with it. Only then will you be able to know the real rate of return from investing in a house.

Otherwise, you will talk like others do, I bought it at x and I sold it at 2x, and get lost in the big numbers, thinking you have made huge returns. While this sort of conversation sounds impressive, it doesn't mean anything.

**2)** Don't buy a house to generate a regular income. The home rentals in the bigger cities have come down post covid. Even if they haven't, the rental yields (rent divided by market price) continue to be lower than what you would earn if you had that money invested in a fixed deposit (despite such low interest rates).

Of course, the corollary here is that as a landlord you choose to declare your rental income and pay an income tax on it. Many landlords prefer to be totally or partially paid in cash and choose not to pay any income tax.

**3)** From what I have been able to gather from my conversations, people in a few cities are still flipping houses. In fact, the trick is to invest before a project gets a RERA approval and then sell out as soon as the approval comes through. This reminds me of the old days when the builder never really knew the people who ended up living in the homes that had been built.

Anyway, if you are flipping homes, do remember that many people caught in the real estate shenanigans of 2009 to 2011, are still waiting for their homes. Many of them are investors. So, if you are flipping homes, do take some basic precautions like not betting your life on any one deal. As the old cliche goes, don't put all your eggs in one basket.

**4)** Also, do remember that you are an individual and the builder is a builder. While many stories of David beating the Goliath have come out in the media, many *more* stories of Goliaths having crushed Davids, never made it to the media.

It was, is and will remain, an unequal fight. Do remember that. For a builder this is the life that he leads, you, dear reader, on the other hand, have many other things to do. And you are looking for a home to live in, not a builder to take on. So, be careful.

**5)** One question that I often get is, which bank/housing finance company should I take a loan from. I don't think this should matter much. Most big banks and housing finance companies charge similar interest rates. As we say in Hindi, *bus unees bees ka farak hai*.

So, go to the financial institution which seems to be the most convenient to you.

**6)** One story being pushed in the media is that you should buy a home now because interest rates are low. Among *many dumb reasons* for buying a home, this is by far the dumbest. Interest rates on home loans are not fixed but floating interest rate loans. If the cost of borrowing for banks and housing finance companies goes up, so will the interest rate on floating rate home loans.

No one can predict which way interest rates will go in the medium to long-term (That doesn't stop people from trying. Many economists build careers around this). So, currently, the interest rate on a home loan is around 7% per year or thereabouts. If you are buying a home, make sure that you have the capacity to keep repaying the EMI even at an interest rate of 10% per year. This is very important.

**7)** How do you structure the amount you pay for the home? What portion of the home price should be a downpayment? What portion of the home price should be your home loan? These are very important questions. The answer varies from person to person. Nevertheless, the one general principle I would like to state here is that don't dip into your retirement savings *as far as possible* to pay for the downpayment.

It might seem like a good idea with retirement far away and your parents encouraging you to do so because they did the same and it worked out fine for them. Nevertheless, do remember that on an average the current generation will live longer than its parents, and the family support that your parents had or will have in their old age, you may never have.

**8)** Also, from the point of diversification, it makes sense not to bet all your savings on making the downpayment for a home. Do remember, no job or source of income is safe these days. Further, do ensure that at any point of time you have the ability to pay six to 12 EMIs, without having a regular source of income.

Other than being able to continue repaying your EMI, it will also help you have some time to look for a job or another source of income, if the current one goes kaput.  Money in the bank, buys you time, which helps you make better decisions in life.

And most importantly, if your EMI is more than a third of your take home salary or monthly income, rest assured you are in for trouble on the financial front.

**9)** If you want to buy a home to live in, go for a ready to move in home. I have seen completion dates for RERA approved projects going beyond 2025 in Mumbai.

The other advantage with a ready to move in home is that some people are already living there and if there is some problem with the building (not a huge deal in India) then there are many more people who have a stake in solving the problem (as convoluted as this might sound). As always there is strength in numbers.

**10)** Finally, be sure why you are buying a home. You want to live close to your place of work. You want your child to have some stability in life. You don't like the idea of moving homes, every couple of years. And so on.

But please don't buy a home because your parents, in-laws, extended family or relatives, expect you to do so and it gives them something to chat up on or some meaning to their lives. These are *financially difficult* times and making the biggest financial decision of your life to impress others, isn't the smartest thing to do possibly.

To conclude, as I said in the beginning this isn't a complete list by any stretch of imagination. Each person's situation is unique. Also, you may not end up with a tick mark on all these points mentioned above and you may still end up buying a home. But the advantage will be that you will know clearly where you are placed in the financial scheme of things.

The points essentially help you think in a structured way to arrive at a decision. They do not make the decision for you. That you will have to do.

PS: Don't know if you noticed that the terms house and home, have been used at different places. Hope you appreciate the difference between the two.

8 April, 2021

# RBI to Print Rs 1 Lakh Crore to Keep Government Happy


After Lehman Brothers, the fourth largest investment bank on Wall Street went bust in September 2008, the Federal Reserve of the United States, the American central bank, came up with three rounds of large-scale asset purchases (LSAP). The LSAP was popularly referred to as quantitative easing or QE.

Yesterday, Shaktikanta Das, the governor of the Reserve Bank of India (RBI) announced a similar sounding GSAP or G-sec acquisition programme, where G-sec stands for government securities. India now has its own planned QE. (At the risk of deviation, it's not *just* the Indian film industry which copies the Americans, our central bank also does.)

The government of India issues financial securities known as government securities or government bonds, in order to finance its fiscal deficit or the difference between what it earns and what it spends. Banks, insurance companies, non-banking finance companies, mutual funds and other financial institutions, buy these securities. Some are mandated to do so, others do it out of their own free will.

What does GSAP entail? Like was the case with the Federal Reserve and the LSAP, the RBI will print money and buy government securities. For the first quarter of 2021-22 (April to June), the RBI has committed to buying government securities worth Rs 1 lakh crore. The first purchase under GSAP of Rs 25,000 crore will happen on April 15, later this month.

Why is this being done? Among other things, the RBI is also the debt manager for the central government. It manages government's borrowing programme. After borrowing Rs 12.8 lakh crore in 2020-21, the government is expected to borrow another Rs 12.05 lakh crore in 2021-22. Due to the covid-pandemic and a general slowdown in tax revenues over the years, the government has had to borrow more in order to finance its expenditure and the fiscal deficit.

This information of the government having to borrow more than Rs 12 lakh crore again in 2021-22, came to light when the annual budget of the central government was presented on February 1. Due to this higher borrowing, the bond market immediately wanted a higher return from government securities.

The return (or yield to maturity as it is more popularly know) on 10-year government securities as of January 29, had stood at 5.95%. By February 22, the return had jumped to 6.2% or gone up by 25 basis points, in a matter of a few weeks. One basis point is one hundredth of a percentage.

The yield to maturity on a security is the annual return an investor can expect when he buys a security at a particular price, on a particular day and holds on to it till its maturity.

As the latest monetary policy report of the RBI released yesterday points out: "Yields spiked following the announcement of government borrowings of  Rs12.05 lakh crore for 2021-22 and additional borrowing of Rs 80,000 crore for 2020-21."

In May 2020, the government had announced that it would borrow a total of Rs 12 lakh crore in 2020-21. When the budget was presented, the government said that it would end up borrowing Rs 12.8 lakh crore or Rs 80,000 crore more.

At any given point of time, the financial system can only lend a given amount of money. When the demand for money goes up, it is but natural that the return expected by the lenders will also go up. This led to the bond market demanding a higher rate of return on government securities, pushing up the yields or returns on government securities.

How did this become a bother for the government? When the returns on existing government securities go up, the RBI has to offer higher rates of interest on the fresh financial securities that it plans to issue on behalf of the government to fund the fiscal deficit. This pushes up the interest bill of the government, which the government is trying to minimise.

Government securities are deemed to be the safest form of lending. Once returns on these securities go up, the interest rates in general across the economy tend to go up, which is not something that the RBI wants at this point of time. The hope is that lower interest rates will help the economy revive faster.

As the debt manager of the government, it's the RBI's job to offer the best possible deal to its main client. Hence, post the budget, the RBI got into the job quickly and to drive down returns on government securities launched an open market operation (OMO). As the monetary policy report points out: "Yields subsequently eased somewhat on the back of… the OMO purchases for an enhanced amount of Rs 20,000 crore on February 10, 2021."

In an OMO, the RBI prints money and buys government securities from those institutions who are willing to sell them. The idea here is to pump more money into the financial system and in the process ensure that yields or returns on government securities go down.

With the GSAP, the RBI has just taken this idea forward. While the GSAP is not very different from the OMOs that the RBI carries out, it is more of an upfront commitment and clear communication from the RBI that it will do *whatever it takes* to ensure that yields on government securities don't go up. Like between April and June, the RBI plans to print and pump Rs 1 lakh crore into the financial system.

Let me make a slight deviation here. In this case, the RBI is also *indirectly financing* the government's fiscal deficit. As the debt manager for the government, the RBI sells fresh securities to raise money in order to help the government finance its fiscal deficit.

These securities are bought by various financial institutions. When they do this, they have handed over money to the RBI, which credits the government's account with it. In the process, the financial institutions as a whole have that much lesser money to lend for the long-term.

By printing money and pumping it into the financial system, the RBI ensures that the money that financial institutions have available for lending for the long-term, doesn't really go down or doesn't go down as much,

Hence, in that sense, the RBI is actually *indirectly* financing the government borrowing. (It's just buying older bonds and not newer ones directly). A reading of business press tells me that the bond market expects more money printing by the RBI during the course of the year. One particular estimate going around is that of more than Rs 3 lakh crore . In that sense, even if the RBI prints Rs 3 lakh crore, it will indirectly finance around a fourth of the government borrowing given that it is scheduled to borrow Rs 12.05 lakh crore in 2021-22.

Now getting back to the topic. Like in any OMO, while carrying out a GSAP operation, the RBI will print money and buy government securities. In the process, it will put money into the financial system. This will ensure that returns on government securities don't go up. In the process, the government will end up borrowing at lower rates.

This is how the RBI plans to keeps its main customer happy. It needs to be mentioned here that with the second wave of covid spreading across the country, chances are economic recovery will take a backseat and the government will have trouble raising tax revenues like it did in 2020-21, the last financial year.

This might lead to increased borrowing on the government front. Increased borrowing without the RBI interfering will definitely lead to the bond market demanding higher returns from government securities. With the GSAP, the hope is that yields or returns on government securities will continue to remain low.

It is worth remembering that Shaktikanta Das' three year term as the RBI Governor comes to an end later this year. Hence, at least until then, it makes sense for Das to keep Delhi happy.

Of course, the money printing leading to lower return on government securities, will also ensure that the interest you, dear reader, earn on your fixed deposits, will continue to remain low, and the real rate of interest after adjusting for the prevailing inflation, will *largely* be in negative territory.

As mentioned earlier, lending to the government is deemed to be the safest form of lending. And if that lending can be carried out at low rates, the other rates will also remain low. This is the cost of the RBI trying to help the government, the corporates and the individual borrowers. It comes at the cost of savers. This is interest that the savers would have otherwise earned.

It is as if the RBI is telling the savers, don't have your money lying around in deposits. Chase a higher return. Buy stocks. Buy bitcoin.

If the RBI had let the interest rates find their own level, with the government borrowing more, the interest rates would have gone up and helped the savers earn a higher return on their deposits. This would have also encouraged consumption, especially among those individuals whose expenditure depends on interest income. The argument offered by economists over and over again is that lower interest rates lead to higher borrowing and faster economic recovery.

Let's take a look at this in the case of bank lending to industry. As of February 2021, the total bank lending to industry stood Rs 27.86 lakh crore. As of February 2016, five years back, the total bank lending to industry had stood at Rs 27.45 lakh crore.

Over a period of five years, the net bank lending to industry has gone up by a minuscule Rs 40,731 crore or just 1.5%. Meanwhile, the interest rate on fresh rupee loans given by banks during the same period has fallen from 10.54% to 8.19%, a fall of 235 basis points.

So much for corporates borrowing more at lower interest rates. This is their *revealed preference* ; the actions that they are taking and not the *bullshit* that they keep mouthing on TV and in the business media. Currently, the Indian corporate simply isn't confident enough about the country's economic future and that's the reason for not borrowing and expanding, irrespective of the public posturing.

Anyway, the point is not that higher interest rates are required. But the point is that if the RBI did not intervene like it has been doing, by printing money and buying bonds, slightly higher interest rates which would put the real interest rate in positive territory, would have been the order of the day. And that would have been better than the prevailing situation. A little better for the savers about whom neither the RBI nor the government seems to be bothered about.

But then as I said earlier, the government is the RBI's main customer these days. And that's the long and the short of it.

6 April, 2021

# राजा बाबू से मंडेला — निर्मल आनंद से इंटेलेक्चुअल सटिस्फैक्शन तक का सफर


कल शाम को चैनल बदलते बदलते, या फिर ये कहिये कि OTT बदलते बदलते, नज़र एक तमिल फिल्म पर आकर टिकी. नाम था, *मंडेला* .

खाना खाते खाते फिल्म का पहला आधा घंटा देखा. मज़ा आया. फिल्म एक ब्लैक कॉमेडी है और ब्लैक कॉमेडी और हमारा तो पुराना याराना है. खैर, फिर कुछ काम आ गया इसलिए पूरी फिल्म नहीं देख पाया. एक-आद दिन में निपटा दूंगा.

रात को तकिये पर सर रखने से लेकर नींद आने तक, मेरे दिमाग में एक ख्याल आया. आजकल हमारे लिए एक हिंदी फिल्म देखना बहुत ही मुश्किल हो गया है.

एक ज़माना था जब हम सिनेमा निर्मल आनंद के लिए देखते थे. अब हम फिल्म निर्मल आनंद के साथ साथ, इंटेलेक्चुअल सटिस्फैक्शन के लिए भी देखते हैं. और जब तक इंटेलेक्चुअल सटिस्फैक्शन नहीं होता तब तक निर्मल आनंद भी नहीं आता है.

अब जनवरी 21, 1994, की बात ले लीजिए. राँची के सुजाता सिनेमा में डेविड धवन कृत *राजा बाबू* लगी थी. हम लोग फर्स्ट डे फर्स्ट शो देखने पहुंचे. लाइन में लगे और थोड़ी धक्कम धुक्की होने के बाद हम लोगों को ड्रेस सर्किल की टिकेटें मिल गयी. ये वो दिन थे जब फिल्म देखने से ज़्यादा मज़ा फिल्म की टिकट मिलने में आता था.

फिल्म शुरू हुई. वो गोविंदा का ज़माना था. और अगर साथ में अगर करिश्मा कपूर, कादर खान, शक्ति कपूर, समीर, आनंद मिलिंद और डेविड धवन, भी हों, फिर तो सुभान अल्लाह. गोविंदा के अलावा ये सभी लोग *राजा बाबू* से जुड़े थे. पर फिल्म में वो मज़ा नहीं था जितना कि गोविंदा की फिल्मों में अमूमन हुआ करता था.

दो घंटे से ऊपर गुज़र चुके थे और पूरे हॉल में एक सनाटा सा छाया हुआ था. लग ही नहीं रहा था कि गोविंदा की फिल्म चल रही है. उसी साल आयी द्रोहकाल, जो कि एक ज़बरदस्त आर्ट मूवी थी, के शोज में, उस दिन से ज़्यादा हल्ला हुआ था. (जी हाँ हम उस समय भी आर्ट फ़िल्में देखा करते थे वो भी सिनेमा हाल में जाकर).

फिल्म ख़त्म होने से कुछ समय पहले, परदे पर आया उस साल का एकदम सुपरहिट गाना. *सरकाये ल्यो खटिया जाड़ा लगे* . और पब्लिक ने तब तक गोविंदा और डेविड धवन से हुआ सब गिला शिकवा माफ़ कर दिया. कुमार साणु और पूर्णिमा के इस गाने ने एकदम बवाल मचा दिया. अगर अंग्रेजी में कहें तो द ऑडियंस वास् डांसिंग इन द aisles.

वो ज़माना था डबल मीनिंग गानों का और *सरकाये ल्यो खटिया जाड़ा लगे* , मेरे हिसाब से, इन डबल मीनिंग गानों की लिस्ट में नंबर दो की पायदान पर आता है. आप पूछेंगे कि नंबर वन गाना कौन सा था. अब ये भी कोई बताने वाले बात है. हिंदुस्तान में रहकर, हिंदी सिनेमा देखने के बाद अगर इतना भी नहीं पता… तो आप एंटी नेशनल, टुकड़े टुकड़े गैंग में शामिल हो चुके लुट्येन्स दिल्ली के आखरी लिबरल हैं.

ख़ैर, आप भी ये सोच रहेंगे के मैं भी कहाँ मंडेला से शुरू करके राजा बाबू तक पहुँच गया. शायद ये समझाने की कोशिश कर रहा था कि उस ज़माने में फिल्मों से सीधी सीधी अपेक्षा होती थी.

फिल्म का हीरो थोड़ा रोमांस करेगा, गाना गायेगा, नाचेगा, विलेन की पिटाई करेगा और अगर इन सबके ऊपर अगर कॉमेडी भी करे, फिर तो पूरा पैसा वसूल.

रही हीरोइन की बात तो वो भी रोमांस करेगी, गायेगी, नाचेगी और थोड़ा रोयेगी.

अगर फिल्म में विलेन है तो वो हीरो-हीरोइन के बीच में अपनी टाँगे अड़ाएगा. जैसा की मोहनीश बहल मैंने प्यार किया में कहते हैं, एक जवान लड़का और एक जवान लड़की कभी अच्छे दोस्त नहीं हो सकते. पहले कुछ इस किस्म उलटी-पुलटि बात करेगा और अंत में हीरोइन के साथ थोड़ी बहुत बदतमीज़ी भी, जिसके बाद हीरो आकर उसकी पिटाई करेगा.

हीरो की माँ रोएगी और अपने बच्चे के लिए अच्छी नौकरी और अच्छी बीवी की दुआ करेगी.

और फिर, एवरीवन विल लिव हैप्पिली एवर आफ्टर.

अगर किसी भी फिल्म में इन सब चीज़ों का ठीक ठाक सा मिश्रण मिल जाता था, तो लोग उस फिल्म को दो एक बार देखकर चला ही देते थे. और हम भी ऐसी पब्लिक का हिस्सा थे काफी सालों तक. कम से कम 1993 से 1999 तक, जब हम रांची के सिनेमा घरों में अक्सर सिनेमा फर्स्ट डे फर्स्ट शो देखा करते थे. (करीब दस साल हो गए कोई भी फिल्म फर्स्ट डे फर्स्ट शो देखे हुए. अब जब आराम से ऐसा किया जा सकता है, तो मन नहीं करता है.)

1999 के बाद चीज़ें बदली. थोड़ा पढ़ लिख ज़्यादा गये. थोड़ा अंग्रेजी सिनेमा देख लिया. और 2006 से 2009 के बीच में बहुत सारा इंटरनेशनल सिनेमा भी.

अंग्रेजी फ़िल्में देखने के बाद ये पता चला की उनकी फ़िल्में हमारे फिल्मों से कितनी बेहतर बनती हैं, या फिर हम लोग सीन बी सीन कॉपी करते हैं. अब शायद पॉसिबल नहीं है पर एक ज़माने में तो होता ही था. यकीन नहीं आता तो कभी 1934 की हॉलीवुड फिल्म, *इट हप्पेनेड वन नाईट* देखे और इसके बाद महेश भट की 1992 की फिल्म *दिल है के मानता नहीं*. सीन बाय सीन कॉपी है.

यहाँ तक कि *इट हप्पेनेड वन नाईट* के डायलॉग्स को सीधे सीधे हिंदी में ट्रांसलेट किया गया है. और आश्चर्य की बात तो ये है कि डायलाग लिखे थे मशहूर लेखक शरद जोशी जी ने.

जब इंटरनॅशनल सिनेमा देखा तो ये समझ आया की सीरियस मुद्दों पर भी फ़िल्में बनायीं जा सकती थी. और रोमांस, नाच, गाना, मार धाड़ के अलावा, फिल्मों में नुआन्स (nuance) भी हो सकता है. और निर्मल आनंद के अलावा फ़िल्में इंटेलेक्चुअल सेटिफेक्शन भी दे सकती हैं.

और धीरे धीरे इंटेलेक्चुअल सटिस्फैक्शन हावी होता गया. केवल ये काफी नहीं था कि स्क्रीन पर क्या चल रहा है. ये भी जानना ज़रूरी था की फिल्म के डायरेक्टर और लेखक की पॉलिटिक्स क्या है. उन्हें इंस्पिरेशन कहाँ से मिला है. फिल्म के डायलॉग्स में दम है की नहीं. वगैरह वगैरह. एक फिल्म देखने में और एक किताब पढ़ने में ज़्यादा अंतर नहीं रह गया.

और इसका नतीजा ये हुआ की धीरे धीरे हिंदी फ़िल्में देखना एकदम बंद सा हो गया है, क्यूंकि किसी भी फिल्म से जो उमीदें थी, वो बहुत ज़्यादा बढ़ गयी. और जैसे जैसे हमारा टेस्ट बदला वैसे वैसे गोविंदा का करियर भी ख़तम होता चला गया. क्यूंकि गीता का सार है, परिवर्तन ही इस दुनिया का नियम है.

अब खोज रहती है अच्छी फिल्मों की. भाषा चाहे कोई भी हो, क्यूंकि मर्द को दर्द नहीं होता और इंटेलेक्चुअल सटिस्फैक्शन ज़रूरी है.

6 April, 2021

# Only 1.7% of Central Govt Petrol Taxes Shared with States – Where Has Cooperative Federalism Gone?


*Note:* Detailed analysis takes time. Like this piece took three weeks to write. Hence, please continue supporting this effort . Every rupee helps.

**Chintan Patel and Vivek Kaul**

The devil, as they say, is always in the detail.

Nevertheless, in an era of instant digital journalism, where you, dear reader, are constantly bombarded with information, the real story, or should we say stories, often get buried under numerous headlines, lazy journalism, government press releases and the false news that is the flavour of the day.

But if one is willing to do some basic number-crunching, like we are, some interesting details and narratives can emerge.

This is one such story of the central government taking both the states and the common man, for a ride and that too in broad day light. At the risk of stretching the metaphor a bit too far, the scene of the crime is the petrol pump and the motive, the dire state of the economy.

But to do this story full justice, we need to set up the background with some dry, academic points as well as digress into some adjacent details.

So, kindly bear with us. While sensational things might get you excited and help us get a few more clicks, but as we said at the beginning, the devil is in the detail.

And here's presenting the detail.

**What's the point?**

Over the years, the central government has been sharing less and less of the overall taxes that it collects, with the state governments. This is the main point we make in this piece.

The annual budget of the central government is presented in February ever year. The budget is analysed by the media in minute detail.

However, amidst all the analyses, one subject that is often ignored is the financial relationship between the central government and the state governments. After all, much of the services that the government provides are in fact delivered by local and state governments.

It is worth remembering that while the central government collects the bulk of the taxes in the country, it's the states that the taxes ultimately come from. And given that, this money in one way or another needs to go back to the states.

But does it? The short answer is no. And there is a longer answer which explains the reasons, has some nuance and which forms the heart of this piece.

This piece is divided into three sections. The first section provides a background on how tax revenue is transferred from the central government to the state governments and the role of the Finance Commission.

The second section focuses on a special tax category – cess and surcharge, their increased prominence in recent times, and how that raises prices of petrol and diesel.

The third and final section examines the trend of total transfer of funds from the central government to the state governments.

This is an opportune time for such an analysis, since this year's Union budget was accompanied by the unveiling of the 15th Finance Commission's report for the period 2021-22 to 2025-26.

So, read on, to find out.

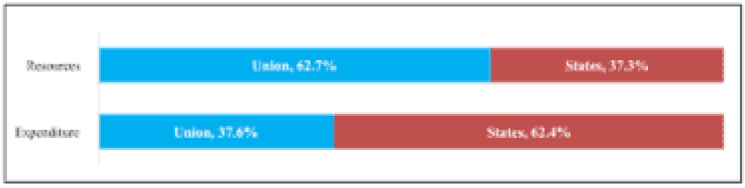
**Who Gets How Much?**

The Constitution stipulates how taxes are collected and split between the central government and the state governments. It empowers the central government as well as the state governments to raise revenues from different sources of taxation.

The central government gets to collect more taxes while the state governments end up with the bigger portion of the expenditure, leading to a mismatch. This mismatch of money that is earned through taxes and other routes and money that needs to be spent, is referred to as a "vertical imbalance".

Take a look at Figure 1. In 2018-19, the Union Government raised 62.7 per cent of the aggregate resources raised by both the Union and states, whereas the states spent 62.4 per cent of the combined aggregate expenditure. While Figure 1 shares data for just one financial year, what's true for 2018-19 has also been true for other financial years.

**Figure 1: Vertical imbalance (2018-19)**




**Source: 15th Finance Commission Report.**

To offset this imbalance, the Constitution provides mechanisms for intergovernmental transfers – the transfer of funds from the central government to the state governments. A key player of this setup is the Finance Commission.

The Finance Commission (FC) is an advisory body that is appointed by the President every five years and which evaluates the state of finances of the central as well as the state governments, and determines how taxes collected by the central government are to be distributed between the central government and the state governments, and among the state governments.

Over and above this, the FC also recommends grants to states based on revenue needs, grants for local governments and grants for specific purposes e.g. health sector grants etc. Thus, there are two broad channels of transfer of funds under the FC umbrella – i) devolution of taxes, and ii) grants.

At the heart of the idea of intergovernmental transfers and tax devolution is the concept of 'divisible pool'. The divisible pool is the portion of the taxes (technically referred to as the gross tax revenue) collected by the central government, which is distributed between it and the state governments. What this means is that all the taxes collected by the central government aren't shareable with the state governments.

Till the tenth FC which tabled its report in 1995, only union excise duties and personal income taxes made up the divisible pool. Under this arrangement, 85% of the personal income taxes and 40-45% of excise duties were shared with the state governments.

In 2000, the tenth FC recommended a constitutional amendment to expand the divisible pool to all central taxes. The central government accepted this recommendation and the 80th Amendment was passed making a certain portion of central government taxes shareable with the state governments, effective retrospectively from April 1, 1996.

Further, the portion of the divisible pool that is shared with the states is referred to as the *devolution of taxes* and is determined by the FC. Before the14th FC which came into effect from April 2015, 32% of the divisible pool was shared with the states.

The 14th FC increased the share of the state governments in the divisible pool to 42%. At the same time, the sector-specific grants were eliminated. This decision was primarily in response to grievances expressed by the state governments. State governments prefer funding through devolution since such transfers are unconditional.

Other transfers of money, whether they are through FC grants, or through channels outside the FC (like schemes from central government ministries) impose policy priorities set by the central government over the state governments, compromising the latter's fiscal flexibility or the ability to spend money as the state government deems fit.

To give an example, a FC health-sector grant can only be used for health spending by the states, or funds transferred to the states under Pradhan Mantri Gram Sadak Yojana can only be used to make roads.

When state governments have more flexibility in allocating funds for various initiatives, they can craft policy that is more responsive to the needs on the ground than having to blindly follow policy that is framed in New Delhi.

The 14th FC recognised this and increased the state share of the divisible pool from 32% to 42%. The intent behind this increase was not to increase the amount of transfers but rather change the composition of the transfers – from diverting conditional funds to diverting unconditional funds, to state governments.

The 15th FC tabled in 2021 lowered the divisible pool marginally to 41%, from the earlier 42%. The is because Jammu and Kashmir is no longer a state and the money allocated to it has not been counted as transfer to a state government. Given this, the 15th FC has kept the divisible pool distribution unchanged.

And now we come to the most important point of this write up. A key detail in this entire discussion is that the only tax revenue that is *excluded* from the shared divisible pool are different kinds of surcharges and cess.

As we shall see next, this exclusion has proved to be the back door that the central government has been using to divert funds from the states governments' kitty to its own.

## A Tale of Two Taxes

Before we get into the details, let's first try and understand what surcharge and cess actually are.

A cess is *tax on a tax* imposed by the central government attached to a specific purpose. For example, an education cess collected should be utilised only for financing education and not for any other purpose. It is worth remembering here that the education cess is imposed on the total income tax and not on the total taxable income.

Hence, as explained earlier, it is a tax on a tax. Examples include infrastructure cess on petrol and diesel, krishi kalyan cess, health and education cess on Income Tax, etc.

In theory, money collected under a cess is to be spent on the specific purpose for which it is collected but that's not always the case.

A Comptroller and Auditor General (CAG) report for 2018-19 indicates that only Rs 1.64 lakh crore of the Rs 2.74 lakh crore or around 60% of the amount collected from cess and surcharge during 2018-19 had been transferred to their respective funds. Around 40% was still retained in the Consolidated Fund of India, which is the general-purpose fund of the Indian government.

The provision of levying a cess was intended to be used for shorter specific purposes. So, the procedure for introducing a cess is comparatively simpler than introducing new taxes, which usually require change in the law.

Coming to surcharges, a surcharge is also a *tax on a tax* , but is not tied to a specific purpose like a cess is. Let's take the example of the surcharge on income tax. It is an added tax on the taxpayers having a higher taxable income during a particular financial year. So, an individual having a taxable income between Rs 50 Lakhs and Rs 1 crore pays an income tax surcharge of 10%.

Further, an individual with a taxable income between Rs 1 crore and Rs 2 crore, pays an income tax surcharge of 15%, and so on.

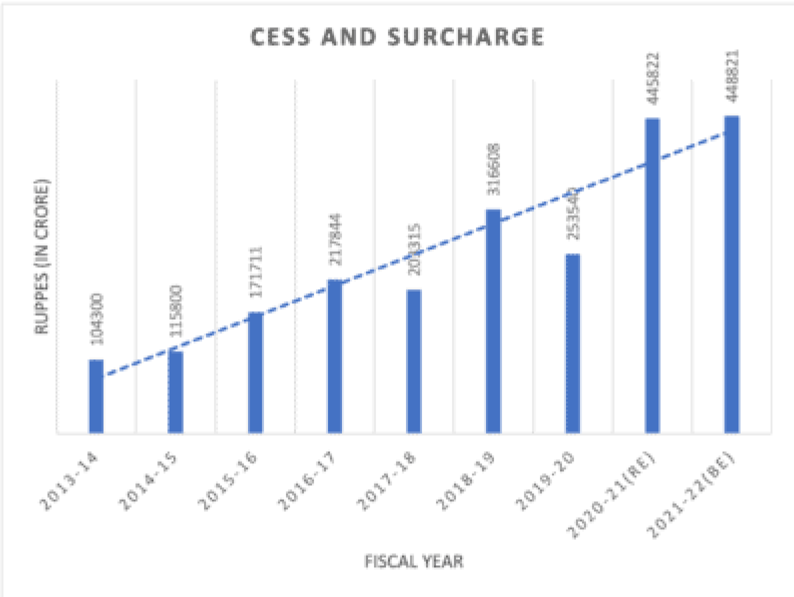
Note that this surcharge is only on the base income tax, not on the income itself. So, if an individual earning Rs 1 crore in a year needs to pay an income tax of Rs 20 lakhs, the applicable surcharge would be Rs 2 lakhs (10% of 20 lakhs).

A surcharge can be utilised for any purpose of the government, without having to bend the rules, like they do sometimes for cess collections.

In the last few years, these surcharges and cess, which do not need to be shared with the state governments, have become the central government's go-to tools to address the tax revenue shortfall.

Take a look at Figure 2a, which basically plots the total amount of surcharges and cess collected by the central government over the years, along with the surcharge and cess it hopes to collect during 2021-22, the current financial year.

**Figure 2a: Total cess and surcharge revenue (in Rs crore).**




**Source: Union budget documents.**

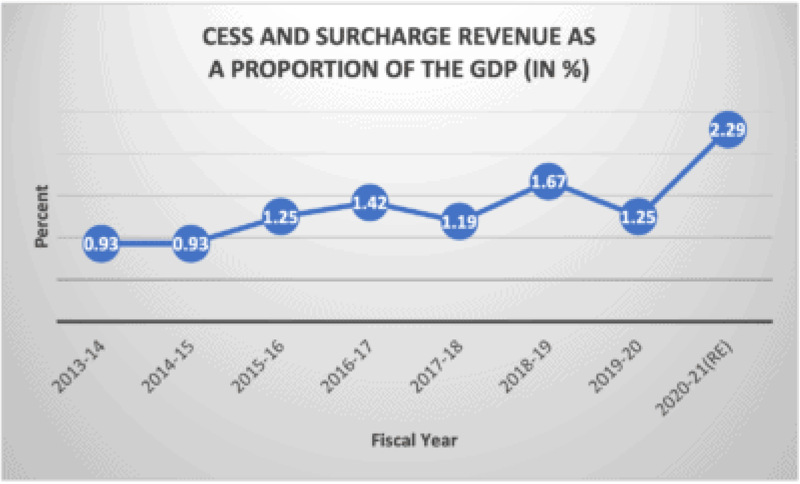
Figure 2a clearly shows that the general trend is upwards, with small blips in 2017-18 and 2018-19. The government expects to collect total surcharges and cess of Rs 4,45,822 crore (revised estimate) in 2020-21.

This is surprising given that overall tax collection during the year is expected to come down. In comparison to the years before 2020-21, the collections for 2021-22 are also expected to be at a very high Rs 4,48,821 crore.

The collections of cess and surcharge surged from Rs 2,53,540 crore in 2019-20 to Rs 4,48,822 crore (RE) in 2020-21, an increase of a whopping 77%. This huge increase is almost entirely due to increased cess and surcharge on petrol and diesel – in particular, the road and infrastructure cess and the additional duty of excise on motor spirit (which is a surcharge), which increased by Rs 1,92,792 crore. Motor spirit is the technical term for petrol.

The increased reliance on cess and surcharge is also seen in Figure 2b below, which plots the total cess and surcharge earned by the central government as a proportion of the Indian gross domestic product (GDP). This is done in order to take the size of the Indian economy into account as well.

**Figure 2b: Cess and surcharge revenue expressed as a proportion of the GDP (in %).**

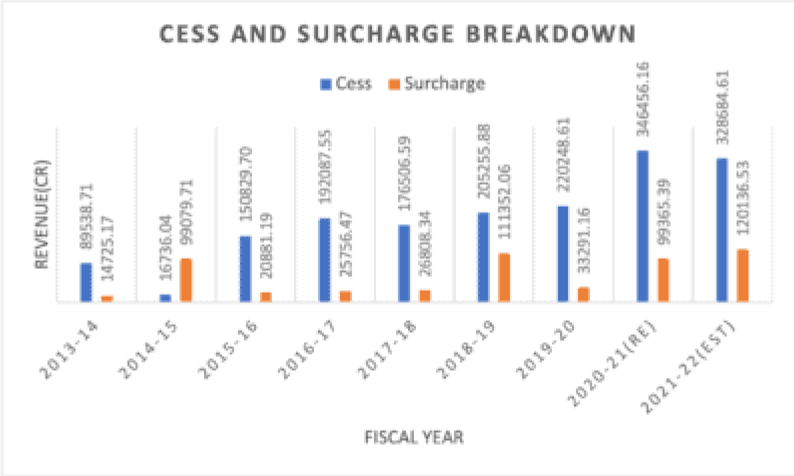



**Source: Union budget documents.**

The above figure makes for very interesting reading. The total amount of cess and surcharges earned by the central government went up from 1.25% of the GDP in 2019-20 to 2.29% of the GDP in 2020-21, a massive jump of 104 basis points. Some of this jump was obviously because the size of the economy or the GDP is expected to contract in 2020-21. Nevertheless, the fact that cess and surcharges collected by the government went up in a year when the economy contracted, does come as a surprise.

In Figure 3, let us look at the breakdown between cess and surcharges earned by the central government over the years. Looking at the below figure it is evident that cess collections form the bulk of the total revenue.

**Figure 3: Cess and surcharge breakdown (in Rs crore).**



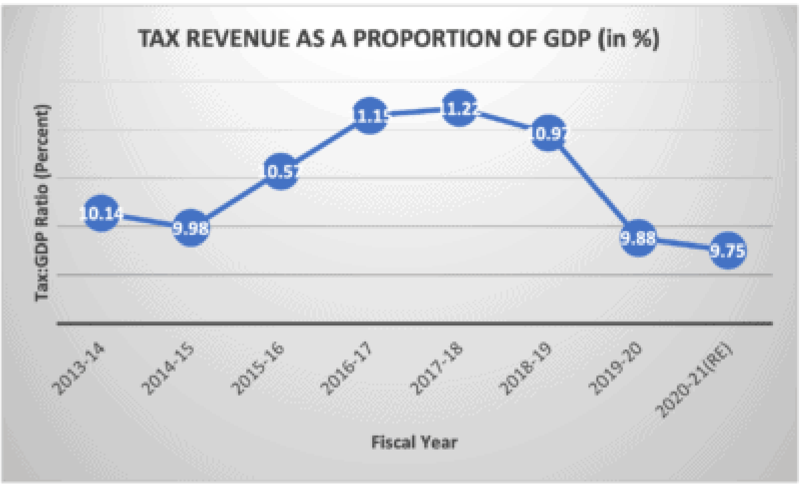

**Source: Union budget documents.**

Clearly, cess is bringing in more money for the central government, though the contribution of surcharges has also jumped up since 2019-20.

Now let's try and understand, why has the central government increasingly become more dependent on earning money through cess and surcharges, and in the process it is sharing lesser proportion of taxes with the state governments.

This increased reliance on cess and surcharges in the last two years can be understood when one looks at what is happening with the total tax revenue. Figure 4 plots the total taxes earned by the central government or gross tax revenue as a proportion of the GDP.

**Figure 4: Gross tax revenue as a proportion of GDP (in %).**



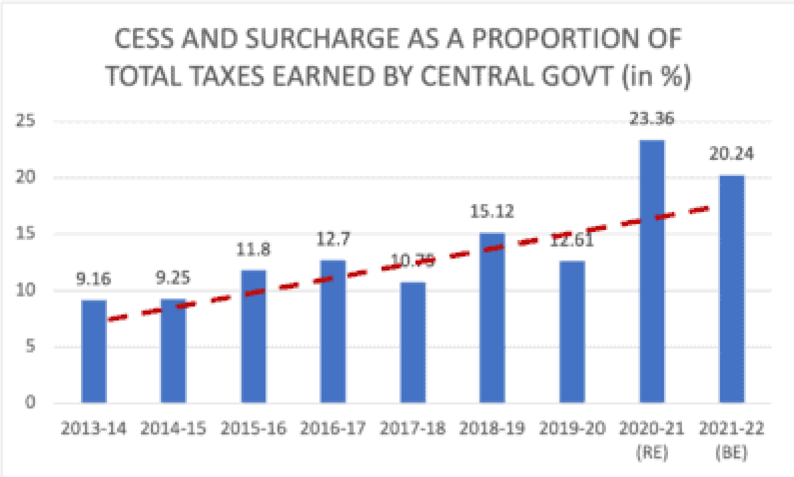

**Source: Union budget documents**

While the negative economic impact of the covid pandemic has been a telling blow, the downward trajectory in tax collections of the central government had started as far as back as 2018-19. The twin economic debacles of PM Modi's first term – demonetisation and a shaky GST implementation – meant the economy was already tottering before the covid pandemic hit.

An obvious casualty of this slowdown has been a declining tax revenue as a proportion of the GDP. In the normal scheme of things, this would have meant that the central government would have ended up with lesser taxes for itself, after sharing with the state governments.

But this fall has been cushioned with the central government earning a higher amount of taxes through cess and surcharges (as can be seen from Figure 5).

**Figure 5: Cess and surcharge as a proportion of total central government taxes.**




**Source: Union budget Documents**

**RE = Revised Estimate**

**BE = Budget Estimate**

In 2019-20, the total taxes earned by the government or the gross tax revenue had stood at Rs 20.1 lakh crore. In 2020-21, it is expected to fall by 5.5% to Rs 19 lakh crore. The net tax revenue of the central government (what remains after sharing taxes with the state governments) in 2019-20 was at Rs 13.59 lakh core.

This is expected to fall to Rs 13.45 lakh crore in 2020-21, a fall of 0.9%, which is much lower than the 5.5% fall in gross tax revenue. While, the total gross tax revenue is expected to fall by Rs 1.1 lakh crore (Rs 20.1 lakh crore minus Rs 19 lakh crore), the net tax revenue is expected to fall by just Rs 14,000 crore (Rs 13.59 lakh crore minus Rs 13.45 lakh crore).

In percentage terms, in 2019-20, the central government kept 67.6% of the taxes for itself in 2019-20. This shot up to 70.8% in 2020-21.

Clearly, the state governments have been short-changed here, with their share of taxes falling from Rs 6.51 lakh crore in 2019-20 to Rs 5.5 lakh crore in 2020-21, *a fall of a little over Rs 1 lakh crore* or 15.5%, in such economically difficult times.

This is primarily because the share of cess and surcharge in total taxes collected by the central government has jumped from 12.67% in 2019-20 to 23.46% in 2020-21. Do remember that cess and surcharges are outside the divisible pool.

So, when the inflow of these taxes increases, the central government gets to keep all the revenue, as opposed to sharing 41% (15th FC guideline) with the state governments. So, it is far more efficient for the central government to increase cess and surcharge when it needs to increase tax collection.

This overuse of cess and surcharges by the central government has not gone unnoticed. In fact, the chairman of the 15th FC, NK Singh has talked about introducing a constitutional amendment to include them in the divisible pool.

As he said :

> *"I see no viable solution except a constitutional amendment. If that constitutional amendment is introduced, recognizing some proportion of cess and surcharge to the divisible pool, it will certainly allow greater flexibility to the successive Finance Commissions subsequently to be able to calibrate a framework."*

Ultimately, as we said at the very beginning, whatever might be the term used, a tax, or a cess or a surcharge for that matter, it is being paid by people. And hence, the money thus collected should be shared with the state governments.

**How does all this affect you, dear reader?**

If you have managed to make it thus far, many of you by now would be like how much *gyan* are these guys going to give. Why can't they tell me straightaway how does all this impact me or the world at large or the *aam aadmi* ?

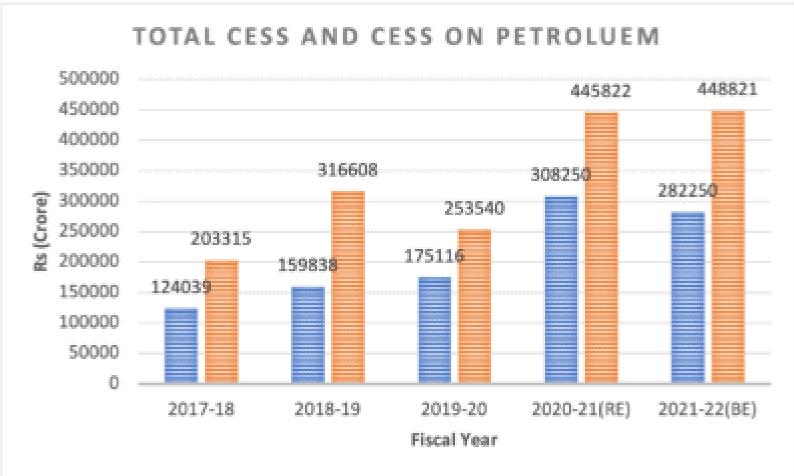
Well, sometimes it is important to take a look at the bigger picture first and then arrive at how it impacts all of us.

The government's increased reliance *primarily* on cess actually has had a direct impact on most citizens – in the form of increased prices at the petrol pump .

The biggest contributor to the spike in cess collection over the last two years has been cess collected on the sale of petroleum products. The figure below charts the total cess collected on petroleum products (crude oil, petrol and diesel) over the last five years. While the cess on petrol formed at least 50% of total cess each year, it was as high as 69% of the total cess revenue in financial years 2019-20 and 2020-21.

Figure 6 clearly shows that the government has resorted to taxing petrol and diesel to make up for revenue shortfalls. This conclusion is hardly a revelation to anyone paying attention to prices at the pump, but the numbers help understand the government's motivation.

**Figure 6: Total cess on petroleum products (in Rs crore).**




**Source: Union budget documents**

There is another way of looking at the cess on petrol and diesel. Table 1 below gives a breakdown of the union taxes on petrol and diesel for 2020-21 and 2021-22. Note that the table below only analyses central excise tax and excludes customs duty. There are technical complications in figuring out the per litre customs duty.

**Table 1: Central government tax breakdown on petrol and diesel.**

| | 2020-21 | | 2021-22 | |
|---|---|---|---|---|
| | Petrol | Diesel | Petrol | Diesel |
| | (Rs/L) | (Rs/L) | (Rs/L) | (Rs/L) |
| Basic Excise Duty | 2.98 | 4.83 | 1.4 | 1.8 |
| Special Additional Excise Duty | 12 | 9 | 11 | 8 |
| Road and Infra Cess | 18 | 18 | 18 | 18 |
| Agriculture Infra Cess | 0 | 0 | 2.5 | 4 |
| Total | 32.98 | 31.83 | 32.9 | 31.8 |
| Cess Percent | 90.96 | 84.83 | 95.74 | 94.34 |

Created with Datawrapper

**Source:** https://www.ppac.gov.in/content/149_1_PricesPetroleum.aspx

The total union excise duty on petrol and diesel, in 2021-22 are Rs 32.90 per litre and Rs 31.80 per litre, respectively, which are marginally lower than the previous year. All taxes other than basic excise duty, including special additional excise duty, which is a surcharge, are exempt from the divisible pool.

**1)** For 2021-22, only ~5% of the excise taxes on petrol and diesel will go to the divisible pool. The rest (~95%) will be kept by the central government. In 2020-21, this portion was at around 91% for petrol and 85% for diesel. Clearly, the government is keeping a greater share of petrol and diesel taxes for itself.

**2)** The above point does not clearly bring out the gravity of the situation. Let's do a simple calculation to show that. In 2021-22, the total excise duty on petrol stands at Rs 32.90 per litre. Of this, the basic excise duty of Rs 1.4 per litre is the only part which is a part of the divisible pool and hence, will be shared with the states. It is worth remembering only 41% of this or around 57 paisa per litre needs to be shared with the state governments.

What this means is that just 1.7% of the total excise duty earned by the central government per litre of petrol will be shared with the state governments. It was at 3.8% in 2020-21.

**3)** Now let's carry out the same exercise for diesel. The total excise duty earned by the central government on the sale of one litre of diesel will be Rs 31.80 during 2021-22. Of this only Rs 1.8 per litre will be shareable with state governments. 41% of this amounts to around 74 paisa per litre.

This amounts to around 2.3% of the total excise duty of Rs 31.8 per litre earned by the central government per litre of diesel. It was at 6.4% in 2020-21.

**4)** In 2021-22, a new agriculture infra cess has been introduced. It amounts to Rs 2.5 per litre on petrol and Rs 4 per litre on diesel. This has led to the reduction of basic excise duty on petrol from Rs 2.98 per litre to Rs 1.4 per litre and that on diesel from Rs 4.83 per litre to Rs 1.8 litre. As mentioned earlier, only the basic excise duty needs to be shared with the state governments.

Hence, by introducing a new agriculture infra cess, the central government has ensured that state governments get an even lower share of taxes from petrol and diesel in 2021-22.

The general public is quite sensitive to price rise at the petrol pump since it is a highly visible and recurrent cost. That the government has still resorted to this strategy for increasing revenue, speaks to the lack of better options – a fact that is a direct consequence of the tepid economic scenario even before the pandemic began. Of course, the covid pandemic has only made things more difficult for the government on tax front.

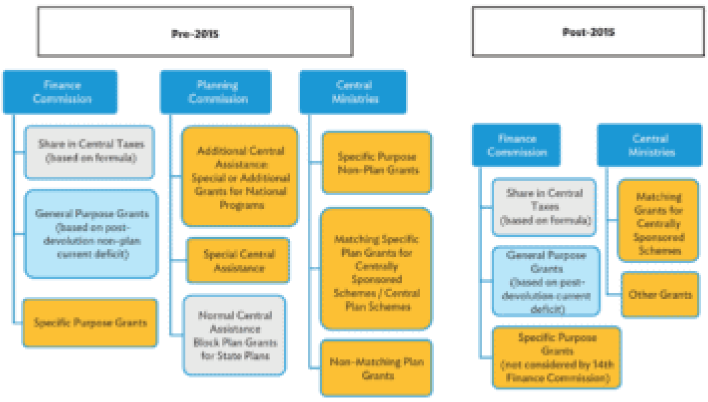
Nonetheless, things are even more difficult for state governments, which don't have many avenues to raise tax. Clearly, this amounts to the centre shortchanging the state governments during difficult economic times.

## Oh wait, there is more – Total intergovernmental transfers

Other than the divisible pool of taxes, there are other channels of intergovernmental transfers between the central government and the state governments. So, to get the complete picture on the flow of money from the central government to the state governments, it is instructive to examine the total intergovernmental funds transferred in more detail.

Before diving into those details, a brief overview of intergovernmental transfers would be useful. Figure 7 below is a good graphical representation of all the ways in which the central government can transfer funds to the state governments.

**Figure 7: Vertical fiscal transfer channels.**




**Source : Asian Development Bank**

Broadly speaking there are two instruments of fund transfers.

**1)** Finance Commission funds: As discussed earlier, this includes the 41% of the divisible pool revenue, general-purpose grants for states with weak revenue raising capacity and specific purpose grants for funding local governments (panchayats and municipalities) and funding certain specific initiatives (eg. health-sector grants by the 15th FC). Most of the funds provided via the FC channel are not conditional and don't require state government contributions.

**2)** Funds from central ministries: In addition to the FC funds, the central government also gives specific purpose grants through the respective ministries. These funds are transferred either through centrally sponsored schemes or central sector schemes. Central sector schemes are entirely funded by the central government. Some examples include the free LPG connections provided to poor households, crop insurance scheme etc.

The centrally sponsored schemes require a matching component from the state governments i.e. they have to fund a portion of the scheme. Examples of this include the Pradhan Mantri Gram Sadak Yojana, the Swachh Bharat Mission etc.

As Figure 7 shows, the mechanism of intergovernmental transfer underwent a major transformation in 2015. Two things led to this. Firstly, the 14th FC gave its recommendations for increasing the devolution share of state governments from 32% to 42% and eliminating a host of specific purpose grants. The underlying rationale was to change the composition of state transfers to increase the "no-strings-attached" outlays and reduce conditional grants to give state governments more financial headroom.

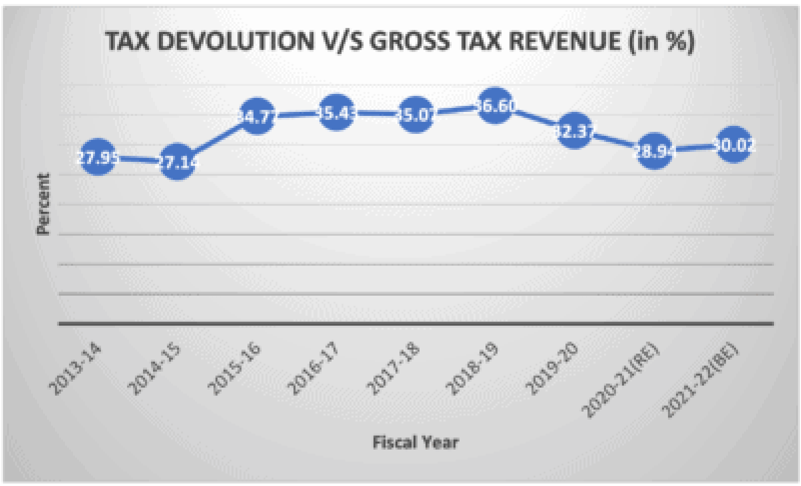
Secondly, the newly elected NDA government disbanded the Planning Commission and replaced it with the NITI Aayog. While the NITI Aayog has some shades of resemblance with the Planning Commission, the five-year plans, which was the responsibility of the Planning Commission, were scrapped.

The five-year plans would have their own grants for states in the annual budget of the central government. The establishment of the NITI Aayog and the approval of the 14th FC recommendations were two initiatives that formed the basis the oft-cited "cooperative federalism" mantra of the NDA government, especially in the early years.

The argument put forth to claim this catchphrase was that the Modi-led administration was reversing the centralising tendencies of earlier governments and ushering in an environment where states had greater fiscal autonomy.

Does the data corroborate these claims? Let us examine. Figure 8 below charts the tax devolution to states as a portion of the gross tax revenue.

**Figure 8: Tax Devolution vs Gross Tax Revenue (in %).**



**Source: Union budget documents**

Some interesting observations can be made from Figure 8.

**1)** The first few years after the 14th FC came to effect (April 2015) saw a significant increase in the portion of taxes devolved to the states.

**2)** This increasing trend of devolution peaked in 2018-19 when the devolution was 36.6%. The last three years have seen this number come down, with the 2020-21 figure (~29%) close to the pre-2015 levels. So, all the talk about cooperative federalism has gone for a toss, in the last few years.

**3)** Note that these numbers don't reflect the 32% (pre-2015) or 42% (post-2015) devolution share prescribed by the FC since cess and surcharge revenue is not devolved. This also explains why the devolution percentage has dipped sharply in the last two years, a period when cess revenue has had a corresponding increase (as shown earlier in Figure 5).

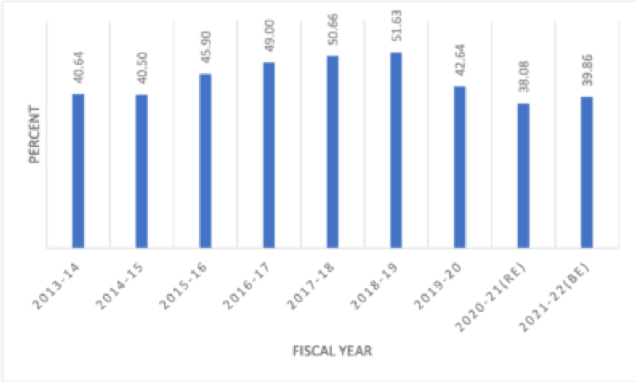
While the 14th FC may have been the catalyst, the Modi government can rightfully claim credit for strengthening fiscal federalism, at least in its first term. However, most of these gains have been reversed in their second term. This justifies N.K Singh's lament :

> *" It should not be a cat and mouse game that every finance commission raises the devolution number and it then neutralised simultaneously by an increase in cess and surcharge leaving the states where they were, nor the opposite way."*

Next, in Figure 9, let us look at the total transfers made to state governments in recent years, not just tax devolution. The total transfers to states includes tax devolution, finance commission grants, centrally sponsored schemes, central sector schemes and other miscellaneous items listed as state transfers in the union budget.

The figure below charts the total transfers made to states as a percent of the total expenditure of the Union government.

**Figure 9: Portion of total expenditure of central government transferred to state governments (in %).**




**Source: Union budget documents**

There are two caveats on the chart above.

**1)** Starting 2014-15 there was a change in how expenditure for central schemes was routed to the states. The figures for 2013-14 have been adjusted to make the comparisons with the subsequent years correctly.

**2)** We have excluded loans made to states from the total transfer amounts and only included grants and devolution, since loans do need to be repaid.

That said, these figures also lead to similar observations made from Figure 8. The period from 2015-16 to 2018-19 (roughly co-incident with NDA's first term) had a significant increase in funding to the state governments.

While the increased devolution of taxes could be attributed to the recommendations of the 14th FC, the increase in total transfer of funds was certainly government policy. The last two years (and the projections for the next year) show a steep decline in the intergovernmental transfers.
The huge spike in cess and surcharge collections which are not shared with states and declining tax revenues during this period contributed to this effect.

There are two other conjectures one can make based on the trends seen above. First, when Narendra Modi won in May 2014, he was a sitting chief minister and his perspective on governance was heavily biased towards the challenges of governing a state.

Hence, financial outlays were *perhaps* favourable to the states. In the second term, he was well-entrenched as a national leader and the instincts were now honed favouring centralisation.

Second, the Bhartiya Janata Party has adopted an increasingly overt approach favouring homogenisation of the country. Whether it is the abrogation of Article 370, the passage of national farm laws, or flirtations with one-nation-one-language, it is evident that impulse is towards uniformity and centralisation. In this context, the trend of holding back funds from states, seems a natural accompaniment.

4 April, 2021

# और मिसेज़ (Mrs) वगैरह गांव में है क्या?


सितम्बर 2006 से मैं प्रभादेवी, मुंबई, के एक छोटे से कमरे में रह रहा हूँ.  मुंबई की कूल भाषा में ऐसे कमरों को स्टूडियो अप्पार्टमेन्ट कहते हैं, पर न ही ये स्टूडियो हैं न अपार्टमेंट. बस एक छत है जो अब तक गिरी नहीं और एकदम तेज़ बरसात में भी पानी अंदर नहीं आता है.

मेरे कमरे में चार अलमारियां हैं जिसमें किताबें हैं. एक और अलमारी है, जिसमें में वो सब चीज़ें हैं जो किसी दिन फेकनी हैं, कुछ पुराने लैपटॉप, फ़ोन और बहुत सारे कपड़े जो अब फिट नहीं होते हैं.

इसके अलावा एक टेबल और दो कुर्सियां हैं, जो भी किताबों से खचाखच भरी हुई हैं. और एक पलंग है. जिस पर में उठता, बैठता, खाता, लिखता और सोता हूँ.

अगर सरल भाषा में कहूँ तो थोड़ा अलग है. जो भी जब भी चाहिए वो सब सामने ही रखा रहता है.

और इस कमरे में जब भी कोई आता है तो, थोड़ा चकित सा रह जाता है. अभी कुछ दिन पहले एक इलेक्ट्रीशियन आया. कमरे के अंदर आते ही थोड़ा भौचक्का गया, पर कुछ बोला नहीं.

दो ट्यूबलाइट बदलनी थी. वो बदलने और पैसे लेने के बाद, वो दरवाज़े पर रुक गया. उससे रहा नहीं गया और उसने पुछा:

"आप लाइब्रेरी चलाते हैं क्या?"

"नहीं," मैंने जवाब दिया.

"तो फिर इतनी सारी किताबें?"

"मेरी हैं."

"हम्म्म. खरीदे हैं?"

"हाँ."

"आप करते क्या हैं?"

“राइटर हूँ.”
“हाँ वो तो ठीक है, पर घर कैसे चलता है?” वो पूछता गया.
“राइटिंग से.”
“सबका चल सकता है क्या?”
“सबका तो पता नहीं, पर मेरा चल जाता है.”
“और मिसेज़ (Mrs) वगैरह गांव में है क्या?”
“नहीं है.”
“गुज़र गयी क्या?”
“नहीं, मैंने कभी शादी नहीं की.”
“तभी.”
“तभी क्या?” मैंने पुछा.
“चल जाता है.”
“शायद.”
“लेकिन सर, एक बात बोले, बुरा मत मानियेगा,” उसने कहा.
“बोलिये.”
“घर तो बीवी और बच्चों से ही बनता है.”
मैं मुस्कुराया और चुप रहा. ऐसी फंडामेंटल बातों पे एक अजनबी आदमी से बहस करना और उसे अपनी ज़िन्दगी का फलसफा समझाना, सही नहीं समझा.  उसने भी हिंट लिया, खुदहाफिज़ कहा और सीढ़ियों की तरफ बढ़ गया.
ये पहला व्यक्ति नहीं है जो मेरे कमरे को देख कर इतना जिज्ञासु हुआ है. मेरे पडोसी बहुत सालों से ये समझने की कोशिश कर रहे हैं कि ये आदमी दिन भर अपने कमरे में बंद रहकर आखिर करता क्या है और इसके पास इतनी सारी अमेज़न की deliveries क्यों होती हैं.
और रही शादी और बच्चों की बात ये तो इसका महत्व मुझे कई लोग पिछले दो दशकों से समझा रहे हैं.
जब मेरे पिताजी ज्योतिष में रूचि रखते थे, तो मेरी माँ अक्सर कहा करती थी, तुम्हारी शादी लेट होगी और तुम्हारे दो बच्चे होंगे. ये अब तक तो सच नहीं हुआ. पर क्यूंकि ये बहुत ही ओपन एंडेड पूर्वानुमान है, आने वाले समय में भी सही हो सकता है. जैसा की जेम्स बांड कह गए हैं, नेवर से नेवर.
मेरे नानाजी एक कदम आगे गए और मेरे शादी न करने पर प्रश्न किया, क्या इसको लड़कियां पसंद नहीं है? ये करीब 15 साल पुरानी बात है, जब मीडिया ने नया नया समलैंगिक लोगों के बारे में बात करना शुरू किया था.
मेरे पिताजी के भाई-बहनों ने जब मेरे ब्याह न करने पर काफी प्रश्न उठाये तो उन्होंने ये कह डाला, भाई अगर मुझे मंडप में बैठना होता तो मैं अब तक बैठ गया होता.
बाकी, जैसा की एक्सपेक्टेड होता है, थोड़ी बहुत इमोशनल ब्लैकमेलिंग रिश्तेदारों की तरफ से तो हुई ही.
अब कोई कुछ नहीं पूछता है. अलग करते करते, मैं इतना प्रेडिक्टेबल हो गया हूँ कि मेरा गॉसिप वैल्यू बिलकुल गिर गया है. जाता हुआ समय सब कुछ बदल देता है.
और अंत में, मजरूह सुल्तानपुरी से क्षमा मांगते हुए, ये दो पंक्तियाँ:
*मैं अकेला ही चला था जानिब-ए-मंज़िल मगर,*
*न लोग ही साथ आये, न ही कारवाँ बना.*

2 April, 2021

# Everybody Loves a Good Interest Rate Cut…Except the Savers

*My main life lesson from investing: self-interest is the most powerful force on earth, and can get people to embrace and defend almost anything* – Jesse Livermore.

Late in the evening of March 31, the department of economic affairs, ministry of finance, put out a press release saying that the interest rates on small savings schemes for the period April to June 2021, have been cut.

The social media got buzzing immediately. And almost everyone from journalists to economists to analysts praised the decision. It was seen as yet another effort by the government to push down interest rates further.

With the state of the economy being where it is, lower interest rates are expected to perk up economic growth. People are expected to borrow and spend more. Corporates are expected to borrow and expand. At lower interest rates individuals who have already taken on loans will see their EMIs go down, leaving more cash in hand, and they are likely to spend that money, helping the economy grow.

That's how it is expected to work, at least in theory. Hence, everybody loves a good interest rate cut… *except the savers* .

On April 1, the social media woke up to the finance minister Nirmala Sitharaman's tweet announcing that "interest rates of small savings schemes… shall continue to be at the rates which existed in the last quarter of 2020-2021." She further said that the order had been issued by *oversight* and would be withdrawn.

Later in the day, the department of economic affairs put out a press release to that effect.

The fact that lower interest rates are good for the economy is only one side of the story. They also hurt the economy in different ways. People who are dependent on interest income for their expenditure (like the retired senior citizens) see their incomes fall and have to cut down on their expenditure. This impacts private consumption negatively.

While this cannot be measured exactly, it does happen. Also, a bulk of India's household savings (close to 84% in 2019-20) are made in fixed deposits, provident and pension funds, life insurance policies and small savings schemes. Lower interest rates bring down the returns of all these products and this negatively impacts many savers.

As the economist Michael Pettis writes about the relationship between interest rate and consumption in case of China, in *The Great Rebalancing* :

> *"Most Chinese savings, at least until recently, have been in the form of bank deposits…Chinese households, in other words, should feel richer when the deposit rate rises and poorer when it declines, in which case rising rates should be associated with rising, not declining, consumption."*

The same logic applies to India as well, with lower interest rates being associated with declining consumption, at least for a section of the population.

This is not to say that interest rates should be higher than they currently are (that is a topic for another day), nonetheless the fact that lower interest rates impact savers and consumption negatively is a point that needs to be made and it rarely gets made. I made this point in a piece I wrote for livemint.com , yesterday.

Also, borrowing is not just about lower interest rates. It is more about the confidence that the borrower has in his economic future and the ability to keep paying the EMI over the years. I wrote about this in the context of home loans , a few days back.

This leaves us with the question that why doesn't anyone talk about the *negative side of low interest rates* . The answer lies in the fact that they don't have an *incentive* to do so. Let's try and look at this in some detail.

**1)** *Fund managers* : Fund managers love lower interest rates because it leads a section of the savers, in the hope of earning a higher return, to move their savings from bank fixed deposits to mutual funds and portfolio management services which invest in stocks. In the process, their assets under management go up. More money coming into the stock market also tends to push up stock prices.

All in all, this ensures that fund managers increase their chances of making more money and hence, they love lower interest rates because their *acche din* continue.

**2)** *Analysts* : Analysts love lower interest rates because it leads a section of the savers, in the hope of earning a higher return, to move their savings from bank fixed deposits to stocks. In order to buy stocks, they need to open a demat account with a brokerage. When the new investors buy stocks, the brokerage earns commissions.

Further, it also means that the interest cost borne by corporates on their debt goes down, leading to higher profits. The stock market factors this in and stock prices go up. Given this, analysts have an incentive to love interest rate cuts.

**3)** *Corporates* : Do I need to explain this? Lower interest rates lead to a lower interest outflow on debt that a corporate has taken on and hence, higher profits or lower losses for that matter. This explains why corporate honchos are perpetually asking the Reserve Bank of India to cut the repo rate or the interest rate at which it lends to banks.

**4)** *Banks:* Banks love lower interest rates simply because at lower interest rates the value of the government bonds they hold goes up. Interest rates and bond prices are inversely related. Higher bond prices mean higher profits for banks or lower losses in case of a few public sector banks. This is why bankers almost always come out in support of interest rate cuts.

This also explains why the bankers hate the idea of small savings schemes offering higher returns than fixed deposits. Lower interest rates on small savings schemes pushes the overall interest rates in the financial system downwards.

**5)** *Economists:* Most economists are employed by stock brokerages, mutual funds, banks, corporates or think tanks. As explained above, stock brokerages, mutual funds, banks and corporates, all benefit from lower interest rates. If your employer benefits from something, you also benefit in the process. Hence, your views are in line with that.

When it comes to think tanks, many are in the business of *manufacturing consent* for corporates. Their economists act accordingly.

**6)** *Journalists:* With the media being dependent on corporate advertising as it is, it is hardly surprising that *most* journalists love interest rate cuts. Further, the main job of anchors on business news channels is to keep people interested in the stock market because that is what brings in advertising. And this can only happen, if stock prices keep going up. In this environment, anything, like interest rate cuts, that drives up stock prices, is welcomed.

Of course, some mainstream TV news channels also run propaganda for the government. So, in their case every government decision needs to be justified. That is their incentive to remain in the good books of the government.

**7)** *Government* : The central government will end up borrowing close to Rs 25 lakh crore during 2020-21 and 2021-22. Hence, even a 1% fall in the interest rate at which it borrows, will help it save Rs 25,000 crore. It clearly has an incentive in loving low interest rates.

The point is everyone mentioned above tends to benefit if interest rates keep going down or continue to remain low. Further, they are organised *special interests* with direct access to the mainstream media. The savers though many more in number aren't organised to put forward their point of view.

Also, it is easier to do the math around the benefits of interest rate cuts and low interest rates than its flip side. As economist Friedrich Hayek said in his Nobel Prize winning lecture, there is a tendency to simply disregard those factors which "cannot be confirmed by quantitative evidence" and after having done that to "thereupon happily proceed on the fiction that the factors which they can measure are the only ones that are relevant."

That's the long and the short of it.

30 March, 2021

# मन के अंदर की मन की बात

कल से शिक्षित बेरोज़गारी का दसवां साल शुरू होने वाला है

जब ये सब शुरू हुआ था तब नहीं सोचा था कि नौकरी से ज़्यादा वर्ष शिक्षित बेरोगज़ारी में गुज़रेंगे. शायद मिडिल क्लास होने कि वजह से एक छोटी सी नौकरी की तलबगारी बनी हुई थी.

पर नौ साल वर्क फ्रॉम होम करने के बाद जो भी थोड़ी बहुत फीलिंग थी नौकरी की तरफ, वो पूरी तरह से ख़तम हो चुकी है. या फिर ये कहना चाहिए कि हम नौकरी करने के लायक रह ही नहीं गए है. प्रबंधन का प्रबंधन करना हमारे बस की बात नहीं है.

दुनिया भर के मैनेजमेंट गुरु entrepreneurship पर मोटी मोटी किताबें लिखते हैं, पर कोई ये नहीं बताता कि एक अच्छी नौकरी में, बॉस के ईगो और सहकर्मियों की असुरक्षाओं को सँभालते हुए, और इन्फ्लेशन से कम इन्क्रीमेंट पर ज़्यादा ध्यान नहीं देते हुए, ईमानदार कैसे बना रहा जाए?

खैर, हमें कौन सा हर महीने EMI देना है कि इन चीज़ों की चिंता की जाए, न ही बच्चों को पढ़वाना है या उनकी शादी के लिए पैसे जमा करने हैं. आपको ये सब करना है, इसलिए, बने रहिये. पिच पर नज़र बनाये रखिये और विकेट बचाये रखिये. कोई भी कभी भी आपकी तरफ गूगली फेंक सकता है, इसलिए उनकी कलाइयों पर ध्यान बनाये रखिये.

समय बहुत कठिन चल रहा है. पहले तो न्यूज़ मीडिया की हालत ख़राब है और ऐसी ख़राब हालत में गेम पूरी तरह से बदल चुका है. हम जैसे अदना लोगों को भी अब नेटफ्लिक्स इत्यादि के साथ compete करना पड़ रहा है.

compete, शायद सही शब्द नहीं है यहाँ पर, पर कहने का मतलब ये है कि लोगों के पास अब भी उतना ही समय है जितना पहले था, पर अब करने को ज़्यादा चीज़ें हैं और वो भी फ़ोन पर. और फ़ोन पर अगर आप गेम ऑफ़ थ्रोन्स से लेकर मिर्ज़ापुर देख सकते हैं, या फिर paaarti हो रही है वाला मीम बना सकते हैं, फिर आप हमारे लिखे को पढ़ने की मगज़मारी क्यों करेंगे. शायद हम भी नहीं करते.

सच बोलिये तो हमने भी न्यूज़ मीडिया को पढ़ना तो लगभग बंद ही कर दिया है. पर हमारी वजहें कुछ अलग हैं.

माओत्से तुंग के 'परमानेंट रेवोल्यूशन' का भारतीय रूप हर सुबह उठकर नहीं देखा जाता. जिन चीज़ों पर बातें होनी चाहिए उन पर बात हो ही नहीं रही, और जिन चीज़ों का कोई मतलब नहीं है, उन पर फलसफे जड़े जा रहे हैं.

खैर, अच्छी बात ये है कि हमने बच्चे नहीं पैदा किये हैं और जिन्होंने किये हैं वो तो व्हॉट्सऐप पर मस्त हैं. इसलिए सब चिल कर रहे हैं, बुत बनकर बैठे हैं. जो बात दिख ही नहीं रही, वो समझ में कैसे आएगी!

प्लान बी ये है कि अगर शिक्षित बेरोज़गारी नहीं चलती रही तो फिर क्राइम फिक्शन लिखेंगे और इन किताबों में उन सभी लोगों का, जिनका असल ज़िन्दगी में गला दबाने का मन किया था, उनको एक-एक करके मारेंगे.

कम से कम मन की दुनिया में मन की बात करने की आज़ादी अब भी बनी हुई है.

और शायद इस मन के अंदर की मन की बात में, आप भी हों. तैयार रहिएगा. बुत बनकर मत बैठे रहिएगा.

25 March, 2021

# On Homes and Home Loans

Yesterday evening I had gone to meet a cousin who lives in the Western suburbs of Mumbai. All along the way, there were billboards of Kotak Mahindra Bank advertising its home loans, which are available at an interest rate of 6.65%.

While the interest rate of 6.65% comes with terms and conditions , such low interest rates have rarely been seen before. It is possible to get a home loan these days at an interest rate of 7% .

A few things have happened because of these low rates. There have been scores of stories in the media citing surveys where everyone from women to HNIs to NRIs to millennials *seem* to want to buy a house and they want to do it right here and right now.

Of course, these surveys have been carried out by real estate consultants, whose *very survival* depends on the real estate sector doing well. Incentives as they say.

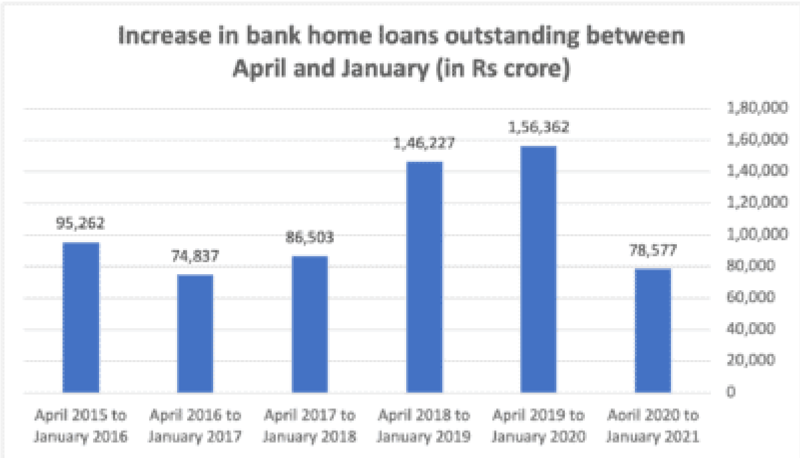
Low interest rates on home loans also have led to stories in the media suggesting that this is best time to buy a house . The other thing that has happened is that analysts have been recommending stocks of home finance companies (HFCs).

The logic being that at lower interest rates people will take on more home loans. This will help the loan book of

HFCs grow, making them good investment bets. *How easy all this sounds?* But is it?

All this stems from the flawed assumption that people borrow more at lower interest rates and live happily ever after. Let's see if that is true or not.

Take a look at the following graph. It plots the increase in home loans outstanding during the period April to January, over the years.




Source: Author calculations on data from Centre for Monitoring Indian Economy.

What does the above graph tell us? It tells us that despite very low home loan interest rates, the increase in home loans given by banks between April 2020 to January 2021, stood at Rs 78,577 crore. This was around half of the increase of Rs 1,56,362 crore between April 2019 to January 2020.

Even between April 2018 and January 2019, the increase stood at Rs 1,46,227 crore. Clearly, people borrowed much more when interest rates were higher. Hence, the logic that people borrow more when interest rates are lower, basically goes for a toss.

In fact, the increase between April 2020 to January 2021, was the second lowest in six years in absolute terms. The lowest increase of Rs 74,837 crore was between April 2016 to January 2017. This period included demonetisation when banks had more or less stopped doing everything else and concentrated on taking back the demonetised notes from the public.

If we look at the period between April 2016 to October 2016, before demonetisation happened, the increase in home loans had stood at Rs 64,501 crore. Clearly the disbursal of home loans slowed down in the post demonetisation months.

There is another point that needs to be made here. Other than banks, HFCs or home finance companies, also give out home loans. Typically, banks give out two-thirds of the home loans and HFCs, the remaining third. Nevertheless, the last couple of years haven't been good for a few HFCs. This has meant that some of the business of home loans has moved from HFCs to banks.

Once we take these factors into account then we can conclude that the increase in home loans during this financial year, has been the worst in six years. And this despite the extremely low interest rates. In percentage terms, the increase in outstanding home loans during this financial year has stood at 5.97%, the lowest in six years, and the only time the increase has been less than 10%.

Why is that the case? For economists and analysts, the interest rate is the most important parameter that people look at while taking a home loan, nevertheless, a little bit of common sense tells us that this isn't the case.

Let's try and understand this through an example. As per HDFC, India's largest HFC, their average home loan size is Rs 28.5 lakh. Their average loan to value ratio at the time of giving the loan is 70%. This basically means that HDFC on an average gives up to 70% of the price of the home as a home loan.

This basically means that the average price of a home in the books of HDFC against which they give a home loan, stands at Rs 40.7 lakh (Rs 28.5 lakh divided by 70%). Let's round this to Rs 41 lakh, for the sake of convenience.

What does this mean? It means that in order to buy a home, other than taking on a loan of the buyer first needs to make sure that he has savings of around Rs 12.5 lakh (Rs 41 lakh minus Rs 28.5 lakh) to make the downpayment on the home loan. Even if the money is available, he or she needs to make sure that they are in a position to spend that money.


This is not where it ends. In many parts of the country a portion of the real estate transaction is still carried out in black. Money needs to be available for that. Further, a stamp duty needs to be paid to the state government. Then there is the cost of moving into a new house (everything from transport to perhaps new furniture).

Once we factor these things into account, we can conclude that the home loan forms around 50-60% of the overall cost of buying a house. Further, in a time like present, any individual thinking of buying a house will have to weigh the decision against the possibility of losing their job or facing a drop in income in their line of work.

Now let's consider the average home loan of Rs 28.5 lakh. At 7% interest and a tenure of 20 years, the EMI on this amounts to Rs 22,096. At 9%, the EMI would have worked out to Rs 25,642. Hence, the EMI is Rs 3,546 lower.

So, yes, the EMI is lower. But what will the buyer first look at? The lower EMI or the ability to be able to pay the lower EMI and be able to continue paying it in the days to come. Of course, the buyer will look at his ability to pay the EMI and be able to continue paying it. Also, it needs to be remembered that the interest rate on the home loan is a floating one, and can rise in the years to come.

Hence, this decision will be based on the confidence that the buyer has in his or her own economic future. This is not something that can be measured at an aggregate system level and varies from buyer to buyer. The point being that everything that is important cannot necessarily be measured in numerical terms.

Having said that, the confidence in the economic future will be currently low, with many individuals losing their jobs or seeing their friends, relatives and acquaintances lose jobs. Hence, other than losing a job, there is also the *fear* of losing the job. There has also been a drop in their income or in some cases small businesses have been shutdown.

Also, whether it is the best time to buy a house or not, like most things in personal finance, it depends on your finances and more importantly your mental makeup of what you want from life. If you want to *settle* in life and make your parents and relatives happy, and have the money to do so, then now is *as good a time as any* to buy a home.

Please keep this in mind at every point of time in life when some expert tells you that this is the best time to do this or the best time to do that.

So, right now if you think you have enough money and enough confidence to keep paying the EMI, and want a home to live in, then please go ahead and buy one. Also, make sure that you have enough savings to pay the EMI for at least six months to a year, even without your main source of income.

To conclude, buying a home is not just about low interest rates. There are several other factors, which people who are in the business of selling real estate, seem to conveniently forget about.

Then there are surveys in which a high proportion of people end up saying they want to buy a home to live in. Of course, they do. But just wanting to do something doesn't add to demand. I mean, I want to buy a house in central Mumbai, but I also know that ain't going to happen. My finances don't allow it.

23 March, 2021

# Vehicle Scrapping Policy is Half-Baked and More About Feeding a Constant Narrative

Late last week the central government announced the vehicle scrapping policy (VSP). As the Minister for Road Transport and Highways, Nitin Gadkari, put it in the Parliament, the aim of the VSP is to create "an eco-system for phasing out of unfit and polluting vehicles".

So how will this be put into action? Using the public private partnership (PPP) model involving the state governments, private sector and the automobile companies, the central government plans to promote the setting up of automated fitness centres (AFCs).

These AFCs will issue vehicle fitness certificates to private vehicles and commercial vehicles based on " emission tests, braking, safety equipment among many other tests which are as per the Central Motor Vehicle Rules, 1989."

A commercial vehicle which is 15 years old and fails the vehicle fitness test will be declared an end of life vehicle and scrapped. Similarly, a private vehicle which is 20 years old and fails the vehicle fitness test will be declared to be an end of life vehicle and scrapped. Further, if owners don't renew the registration certificate, their vehicle may be declared as an end of life vehicle and scrapped.

In order to disincentivise commercial vehicle owners who own vehicles which are 15 years old, from continuing to use them, even if they clear the vehicle fitness test, the fee for the fitness certificate and the fitness test will be set on the higher side. For private vehicle owners with vehicles which are 15 years old, the re-registration fee will be set on the higher side.

The point being that if you have a private vehicle which is 20 years old or perhaps even older, the government wants you to stop using the vehicle and buy a new one, irrespective of what state it is in. For commercial vehicles, the same logic applies for vehicles which are at least 15 years old.

And the *expectation* is this will lead to lower pollution, newer cars, safer pedestrians, more spending, more investment and more jobs. QED.

The minister expects additional investments of Rs 10,000 crore and 35,000 job opportunities to be created because of this.

It will also lead to banks and non-banking finance companies (NBFCs) giving out more loans. Of course, given that the auto industry and the auto-ancillary industry use a lot of contract workers, one could possibly argue that this could lead to more work opportunities for them as well.

The question is how will things really play out? Let's try and understand that in some detail.

Economics is basically the study of incentives and *second order effects* . The trouble is that politicians and policy makers don't keep this in mind while designing policy, particularly the second order effects of what they are proposing.

Let's try and understand this pointwise.

**1)** There are a total of 1.02 crore vehicles, both commercial and private, which fall under the defined category of older vehicles. Even if a small proportion of these vehicles are scrapped they will generate a huge amount of *non-biodegradable waste* .

What plans do we have to handle all this waste coming our way? As the press release announcing the policy pointed out: "Efforts are also being made to set up Integrated Scrapping Facilities across India." Even while taking into account that this policy will be implemented over the next few years, this sounds too much like work in progress than definitive economic policy. One needs a lot more clarity on this front.

**2)** As a way to get the scheme going, the government first plans to scrap its older vehicles. As the press release announcing the plan puts it: "It is being proposed that all vehicles of the Central Government, State Government, Municipal Corporation, Panchayats, State Transport Undertakings, Public Sector Undertakings and autonomous bodies with the Union and State Governments may be de-registered and scrapped after 15 years from the date of registration." This is supposed to be implemented from April 1, 2022 onwards, or little over a year from now.

Why have this blanket policy at a time when governments, in particular state governments, are already short of money? Why not look at the fitness of vehicles and then decide? If at all, vehicles of the central government and the public sector enterprises tend to be decently maintained.

**3)** Also, the assumption here is that only older vehicles cause pollution. The manufacturing of newer vehicles needs electricity. Most electricity in India is generated by burning coal, which causes pollution. Steel goes into the making of vehicles. The process of making of steel, releases carbon dioxide into the atmosphere. That causes pollution as well. The same is true of plastic and pretty much everything else which goes into the making of vehicles. Hence, every new vehicle that is produced has a carbon footprint.

Of course, all this pollution doesn't show up in cities where most private vehicles are driven and tends to be well distributed across the country. But shouldn't a policy that has lower pollution as one of its key points, take this basic factor into account as well? Further, we need to consider the fact that many older private vehicles are not constantly in use.

**4)** As I have explained earlier, the government wants private and commercial vehicle owners to buy new cars. Of course, as and when this happens, the automobile companies are *supposed* to benefit. This explains why companies have come out in favour of this policy (or even otherwise, when do Indian businessmen ever disagree with the government). But this doesn't take a very basic factor into account.

Whatever we might like to say about the new India and such things, we are a poor country at the end of the day. And covid has only made things even more difficult by pushing many more people into poverty, as health bills have mounted, incomes have crashed and small businesses have gone bust.

Hence, assuming that people will go out and buy new vehicles if the older vehicles are scrapped or because re-registration is made more expensive, is just looking at first order effects of policy, in the same way that economists tend to believe that lower interest rates *always* push up consumption.

Private vehicle owners who are not heavy users of their vehicles, might just prefer to use Uber or Ola or even the metro infrastructure coming up across India's major cities. (This reminds me of a time when the government kept telling us that slower automobile sales were primarily because of Uber and Ola).

Further, owners might financially not be in a position to buy a new vehicle. Already, the trucking industry has spoken up against the idea.

Also, even if owners buy a new vehicle, they might cut consumption on something else given that there is only so much money going around. Hence, net-net, the impact on the overall economy may not be much.

The trouble is that the costs of second order effects are not so obvious and straightforward, whereas the supposed benefits are easy to convey in a simplistic way. And politicians love stuff which they can convey in a simplistic way.

**5)** *Kitna deti hai* (how much does it give?), goes a Maruti advertisement, telling us that Indians are *price conscious value for money* consumers. And there is nothing wrong with this, given that an automobile is probably the second most expensive thing we buy during our lifetime. So, while the idea that old polluting vehicles need to be discarded is a noble one, what is in it for the consumer?

This is what the government is planning. a) The owner will be paid 4-6% of the showroom price of a new vehicle, when his old vehicle is scrapped. b) The state governments may be advised to offer a road- tax rebate of up to 25% for personal vehicles and up to 15% for commercial vehicles. c) The vehicle manufacturers are also advised to provide a discount of 5% on purchase of new vehicle against the scrapping certificate. d) The road transport minister has requested the finance minister and states to give a concession in goods and services tax (GST) on purchase of new vehicles.

There are too many ifs and buts in the above paragraph. As usual, the government seems to be in a hurry to announce and implement a policy. As I have said in the past a massive cut in GST on automobiles will encourage buying. What the government will lose out on per unit of sales, it is more than likely to make up for through volumes.

One understands that the road transport minister cannot ensure all of this on his own, which is why it is important that the government spends some time in discussing and figuring out how to design and implement policy. Also, it is important to carry out *small experiments* in union territories, before announcing policies which need to be implemented across the length and the breadth of the country.

As Vijay Kelkar and Ajay Shah write *In Service of the Republic* :

> *"The safe strategy in public policy is to incrementally evolve—making small moves, obtaining feedback from the empirical evidence, and refining policy work in response*

> *to evidence."*

But the trouble is that small moves involve a lot of time, effort and thinking, which is very difficult for a government which believes in constant action and constantly creating new narratives to keep people busy and happy. The narrative also feeds into the idea that the government is trying to do new things.

**6)** Take a look at what happened to two-wheeler sales in 2019-20 (This is before covid struck). Sales fell by nearly 18% year on year to 17.42 million units, as the price went up due to various reasons. Hence, India is a very price sensitive market and the point is that there has to be a huge benefit involved in buying a new vehicle in a *tough* economic environment.

While the notion of pollution control is a noble one, it is not something which is going to get people to go out and buy new vehicles, unless it is very clear what is in it for them. Ultimately, if you want people at large to behave in a certain way, the right incentive should be on offer, something this half-baked policy, like the policy to encourage electric vehicles before it, lacks.

To conclude, one does wonder, what were they doing all these years, given that the policy has been on the anvil for a while now.

17 March, 2021

# Women Are Bearing the Brunt of India's Unemployment Problem


This piece is an extension of a piece on unemployment I wrote sometime back. Nevertheless, you don't have to read that piece in order to make sense of this.

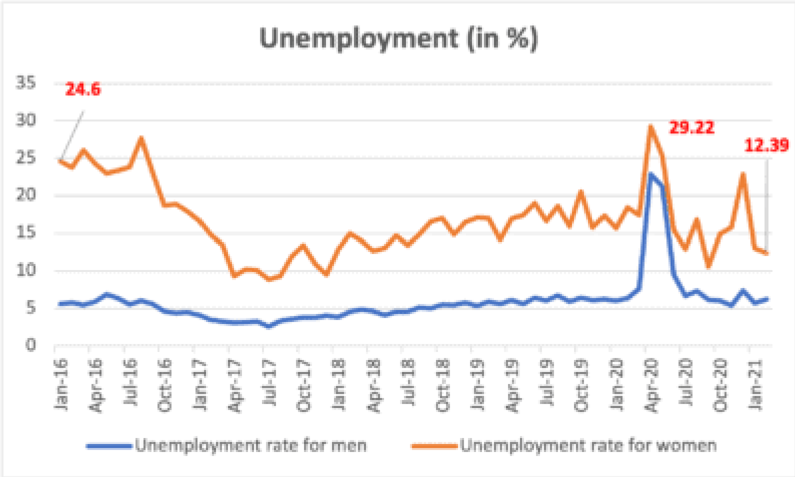
Honestly, this is probably the *most disturbing* data driven piece that I have ever written, despite the fact that I started writing on the issue of unemployment more than half a decade back, when it wasn't very fashionable to do so.

The brunt of India's unemployment problem is being borne by women. This is not to say that the men are having an easy time. They aren't, given that many more men enter the labour force than women.

Nevertheless, the proportion of women who are employed and get paid was low to start with, and it has become even lower over the years. This, at a time, when more and more women are going to school and college.

As the All India Survey of Higher Education for 2018-19 points out: "Total enrolment in higher education has been estimated to be 3.74 crore with 1.92 crore male and 1.82 crore female. Females constitute 48.6% of the total enrolment." But all this education isn't helping them find paid employment.

Let's start with the unemployment rate for men and women. The following chart plots this data since January 2016.




Source: Centre for Monitoring Indian Economy.

The above chart tells us several interesting things.

**1)** The unemployment rate for women is significantly higher than that of men. In February 2021, the unemployment for women stood at 12.39% whereas for men it stood at 6.23%.

**2)** The unemployment rate for women in February 2021 is much lower than it was in January 2016, when Centre for Monitoring Indian Economy (CMIE) published the unemployment data for the first time. Have things improved? Keep reading to know the answer.

**3)** The peak unemployment rate for women during covid was 29.22% as of April 2020. The rate has fallen since to 12.39%, as of February 2021. Again, have things improved?

In order to answer the questions raised above, we need to understand how unemployment is defined. (For those who have read the earlier piece I wrote on unemployment, the next few paragraphs may seem like a repetition, which they are. I have repeated these paragraphs, simply because it is important for every piece to stand on its own, so that first time readers can also read and understand it easily).

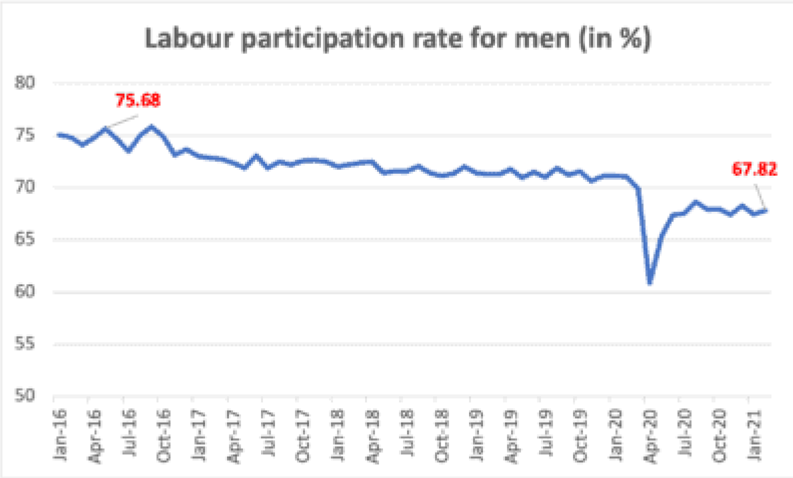
A person is categorised as unemployed "because of a lack of job and where such a person is *actively* looking for a job". The word to mark here is actively. Hence, a person can be categorised as unemployed only if he doesn't have a job and is searching for one.

As the Centre for Monitoring Indian Economy (CMIE) puts it, a person categorised as unemployed, "should be unemployed on the date of the survey, should be actively looking for a job in the 100 hundred days (approximately three months) preceding the date of the survey and should be willing to take up the job if a job is found."

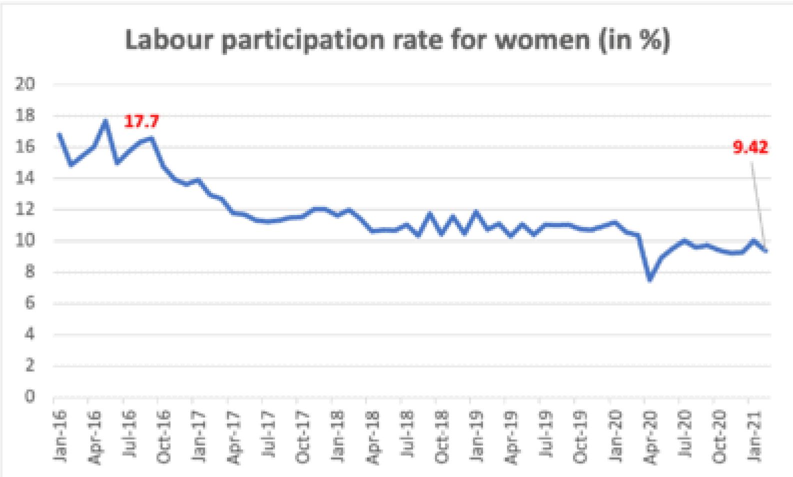
They further point out: "A person is considered to be actively looking for a job if such a person has contacted potential employers for jobs, contacted employment agencies, placement agencies, appeared for job interviews, responded to job advertisements, online employment sites, made applications, submitted resumes to potential employers or reached out to family members, friends, teachers to look for jobs from them."

To put it in short, *waiting for a job offer to come, is not considered as actively looking for a job* .

Let's move on and plot the next two charts, the labour participation rate for men and women.




Source: Centre for Monitoring Indian Economy.




Source: Centre for Monitoring Indian Economy.

Before we interpret these charts, we first need to define what labour participation rate is. Labour participation rate is the ratio of the labour force to the population greater than 15 years of age. And what is the labour force? As per CMIE, labour force consists of persons who are of 15 years of age or more, and are employed, or are unemployed and are *actively looking for a job* .

Now we are in a position to interpret the above two charts. Let's do that pointwise.

**1)** The labour participation rate for women is miniscule on the whole. In February 2021, it stood at 9.42%. What does this mean? It means that a very small proportion of women over the age of 15, are employed and get paid for it or are unemployed and are actively looking for. a job. And the tragic part is that this rate is falling. It was at 17.7% in May 2016. Since then it nearly halved.

**2)** The labour participation rate of men is considerably higher. It was 67.82% in February 2021, even though it has been falling. Hence, two in three men over the age of 15, are employed and are getting paid for it, or are unemployed and actively looking for a job. For women, this ratio is less than one in ten. That's the difference between the two sexes and it's huge.

**3)** Urban women are in a much worse position on this front. The labour participation rate for urban women stood at 6.56% in February 2021. The rate had peaked at 16.58% in August 2016 and has been falling ever since. What does this mean? It means that it is more difficult for a woman to be employed and get paid, if she is in urban India than in comparison to rural India.

Also, the dramatic fall in the rate since August 2016, tells us that once a woman loses a job or a source of income, it is very difficult for her to get it back. And finally, very few women in urban India are stepping out of their homes to go to work and get paid for it. This has only increased post the spread of covid. The labour participation rate for women was 9.92% in January 2020. It's not at 6.56%.

**4)** Now comes the worst part. Between January 2016 and February 2021, the number of women greater than 15 years of age has gone up by 5.41 crore to 49.49 crore. Hence, the number of women who have entered the working age population has gone up by 12.26% (5.41 crore expressed as a percentage of 49.49 crore). On the other hand, the female labour force, has shrunk by 2.75 crore to 4.66 crore. In January 2016, it was at 7.41 crore. This is a collapse of 37% (2.75 crore expressed as a percentage of 7.41 crore).

Let me just repeat this again. While the working age population for women over the last five years has gone up by 12.26%, the female labour force has collapsed by 37.11%. This also explains the fall in unemployment rate for women, given that much fewer women are actively looking for a job. Many women who haven't been able to find jobs, have stopped actively looking and simply dropped out of the labour force.

Economists have struggled to come up with an explanation for this phenomenon. One possible explanation lies in the fact that the number of jobs available haven't grown at the pace that could accommodate the new individuals, both men and women, entering the workforce. Hence, in a patriarchal society, men in deciding positions, have offered jobs to other men, forcing women who have searched and not found jobs to stop actively looking for a job and drop out of the labour force altogether.

**5)** Let's take a look at the overall population. The working age population, between January 2016 and February 2021, has gone up from 93.85 crore to 105.8 crore, this implies an increase of 11.95 crore. Nevertheless, the number of people employed or unemployed and looking for a job, that is the total labour force, has fallen from 44.76 crore to 42.85 crore, or by 1.91 crore.

So, the working age population has increased by 11.95 crore between May 2016 and February 2021, but the total labour force as such has fallen by 1.91 crore. What does this really mean?

While, the total labour force has shrunk by 1.91 crore, 2.75 crore women have dropped out of it. This basically means that the number of men in the labour force has gone up.

Hence, the brunt of India's unemployment problem is being borne by women. Women who lose their jobs find it difficult to find a new one and over a period of time simply drop out of the labour force. Many women who enter the labour force and actively look for jobs, are unable to find one and eventually stop searching and drop out of the labour force.

Given that chances of men finding a job are higher, they continue to look for a job and the situation is not as bad as it is for women. Between January 2016 and February 2021, number of men who crossed the age of 15 and entered the working age population, increased by 6.54 crore to 56.30 crore.

During the same time, the number of men entering the labour force (that is either they were employed or were unemployed and actively looking for a job) increased by 83.62 lakh to 38.19 crore. Hence, in this case of men, the labour force at least hasn't shrunk.


**6)** Given that more and more women are dropping out of the labour force, it makes it easier for the men who don't drop out of the labour force to find a job, from the opportunities that come up. (I am using the word easier here and not easy. Kindly appreciate the difference between the two).

**7)** Urban women are likely to be more educated, but their labour participation rate is very low. Hence, what that means is that they are unable to utilise their education to work and earn money in the process.

**8)** Now let's take a look at how things have been post-covid.  In January 2020, before covid had struck, the working age population had  stood at 103.13 crore. By February 2021, this had jumped to 105.8 crore, a jump of 2.67 crore. Meanwhile, the labour force as of January 2020 stood at 44.24 crore. It has since shrunk to 42.85 crore, by 1.39 crore. So, post-covid, the working age population has gone up by 2.67 crore, but the labour force has shrunk by 1.39 crore.

How have the women done on this front? The working age population post covid for women has gone up by 92.23 lakh whereas the labour force has shrunk by 78.03 lakh. Again, more women have dropped out of the labour force than men, given that the labour force has shrunk overall by 1.39 crore. Also, do keep in mind that the fact that a lower number and proportion of women enter the labour force in the first place.

To conclude, the world celebrated the international women's day a few days back (on March 8). On that day, the corporates and the government institutions talked about the importance of the women who worked for them. The social media influencers talked about women. Many women talked about what it means for them to be a woman.

But almost none of them talked about one of the most important issues at hand, the fact that Indian women are bearing the brunt of India's unemployment problem.

If you are reading this(man or woman) please share it with your friends and family. The first step towards solving any problem is knowing and acknowledging that it exists.

15 March, 2021

# On Confidence

Around mid-November 2020, I spoke to a bunch of macroeconomics students at IIM Ahmedabad on data in economics. After I had spoken, one of the questions asked was how can we use data to say things with absolute certainty (or something along similar lines).

My simple straightforward answer to the question was that *we can't* . Over the years, economists had ended up portraying their subject as a science *simply* because it has a lot of mathematical equations built into it. But macroeconomics was always more of an art. Hence, we could say things with a reasonable amount of confidence, but never with total confidence.

I don't think the student was convinced about what I said. And I don't blame him for it because in the world that he lives in, economists, investors, analysts, politicians and just about everyone speaking to the world at large, is saying things with *total confidence* .

Let's take the case of economists. Their economic growth forecasts are made to the precision of a single decimal point.

If we talk about investors, they forecast a stock market index reaching a particular level in a certain amount of time, with total confidence.

Analysts forecast the price of a stock or a commodity reaching a certain level at a certain point of time.

And let's leave politicians out of this. Untangling their confidence levels will take a book.

The trouble is all this confidence comes in a world that keeps rapidly changing, where if we stick to our ideas all the time, we will largely turn out to be wrong.

As Dan Gardner writes in *Future Babble—Why Expert Predictions Fail and Why Believe Them Anyway* :

> *"The simple truth is no one really knows, and no one will know until the future becomes the present. The only thing we can say with confidence is that when that time comes, there will be experts who are sure they know what the future holds and people who pay far too much attention to them."*

And people pay far too much attention to experts who predict/forecast/comment confidently simply because *confidence convinces* . The audience is looking for a buy in and nothing helps get that more than the confidence of the expert talking.

Also, in these days of the social media, many a time we are simply looking for a confirmation of something that we already believe in. If the expert ends up saying something along those lines, he tends to become our go to man. Our echo chambers are really small.

Let's take the case of the investor Rakesh Jhunjhunwala, a man known to make confident bold statements when it comes to the Indian economy and the stock market. He recently forecast that India will overtake China in the next 25 years. As he put it : "You may call me a fool… but I can tell you one thing – India will overtake China in the next 25 years."

The media and the investors as usual lapped it up, without putting that simple question to him: *How?*

The Indian gross domestic product (GDP) in 2019 was at $2.94 trillion. And that of China was at $11.54 trillion (World Bank data, 2010 constant US dollars). What this means is that if Chinese GDP stagnates at its current level for the next 25 years, India still needs to grow at 5.62% every year for the next 25 years to get where China currently is.

So, the chances of something like this happening are minimal, given the current state of things. But Mr Jhunjhunwala might know something that ordinary mortals like you and I, probably don't.

The funny thing is that the Big Bull, as the media likes to call him, has made similar such forecasts in the past, which have gone horribly wrong. In October 2007, he had forecast that the Sensex will touch 50,000 points in the next six to seven years .

And he is not the only one making such forecasts. In June 2014, the domestic brokerage Karvy had forecast that the Sensex will touch 1,00,000 points by December 2020.

People making a living out of the stock market (or any other market for that matter) have an incentive in saying that future will be better than the present is. Many analysts make a living by simply doing this on the business news TV channels, on a regular basis.

The media looking for bold headlines to run, laps it up. And the investors who are more like sheep ready to be slaughtered, follow the sheep in front of them.

In fact, the trick is to make bold bigger forecasts and not small ones. I mean, if you currently forecast that Sensex is going to touch 55,000 points this year, no one is going to pay interest. But if you say Sensex is going to cross 1,00,000 points by 2023 or 2024, everyone is going to sit up and take interest.

An excellent example of this is Jhunjhunwala's 2014 forecast on the stock market index Nifty touching 1,25,000 points by 2030.

Of course, if he turns out to be right, everyone will be *dazzled* by the forecast he had made. If he turns out to be wrong, no one will remember. Did you remember that Karvy had forecast the Sensex touching 1,00,000 points by December 2020? That's how the game is played.

Big investors are trying to drive up stock prices, so that their investment portfolios can also gain in the process, which is why they publicly need to be seen as being confident.

A similar game is now played on the social media where traders claim to have generated a humongous amount of return in a short period of time. Of course, there is no way to verify this, except believing him or her.

This is accompanied by other confident predictions of how the future is going to be. The idea is to sell some training programme that they are offering. And no one is going to buy a training programme from a trader who doesn't sound confident.

For the economists, the game is a little different. They tend to treat their pet theories as *gospel.* So, an economist who believes in free markets will keep parroting the free market line on everything.

As Scott Galloway writes in his excellent book *Post Corona—From Crisis to Opportunity* :

> *"The libertarian argument… is that…regulation and redistribution is inefficient, that left to its own devices the market will regulate itself. If people value clean rivers, the argument goes, they won't buy cars from companies that pollute. But history and human nature shows that this does not work."*

An excellent example of this is the river Ganga in India, which people keep polluting despite the fact that at the same time they look it as a holy river.

Galloway offers a few more examples. "Nobody wants to see children working eighteen hours a day in a clothing factory, but at the H&M outlet, the $10 T-shirt is an unmissable bargain… Nobody wants to die in a hotel fire, but after a long day of meetings, we aren't going to inspect the sprinkler system before checking in." The point being that some sort of regulation is necessary.

There is economic theory and then there is how things play out in real life. As Adam Grant writes in *Think Again—The Power of Knowing What You Don't Know* : "In theory confidence and competence go hand in hand. In practice, they often diverge."

Other than continuing to believe in their pet theories, there is one more reason for economists to portray confidence. Over the years, they have sold their subject as a science, if not to others, at least to themselves in their heads. I mean the first step before convincing anyone else is to convince oneself first.

Hence, the economic growth figure is forecast to the precision of one decimal point. I have always wondered about how economic growth, which is something very complex and is impacted by so many factors, can be forecast in such a precise way.

Now, this is not to say that the forecasting economic growth is not important. It is very important, simply because without that governments and corporations won't be able to plan for the future.

Without knowing the economic growth number for the next year, a government wouldn't be able to forecast its fiscal deficit or the difference between what it earns and what it spends expressed as a percentage of the country's GDP. Without forecasting the fiscal deficit, the government wouldn't know what kind of money it has to borrow in order to meet this gap. Without the government knowing the government's borrowing target, the country's central bank won't be able to set the country's monetary policy. And so on.

Nevertheless, the world would be a much better place if the economists started forecasting in ranges. Like, in 2020-21, the Indian economy is likely to contract by 8-10% or even 8-9%, rather than saying something as specific like the Indian economy is likely to contract by 8.3%. In this scenario, the governments could also forecast a range when it comes to their fiscal deficit.

As John Maynard Keynes is said to have *supposedly* remarked: "It is better to be roughly right than precisely wrong."

Hence, forecasting ranges and pointing towards the right direction is more important than being extremely precise about the economic growth.

As Tom Bergin writes in *Free Lunch Thinking—How Economics Ruins the Economy* :

> *"If economic models or theories can point us in the right direction and give us a reasonable estimate of the scale of a force or impact, they're helpful. For example, if consumers are building up levels of personal debt that will require ever-rising house prices and wages to sustain – think the United States in 2006 –economists don't need to tell us exactly how much a drop in GDP this situation will likely result in. If they can simply show the risks are unsustainable and material, this can prompt and inform government action and protect society."*

I learnt this the hard way. In 2013, when I first started writing about real estate, looking at the situation at hand, I started predicting a real estate bust very confidently. In the years to come, I turned out to be partly right, with parts of the country seeing a substantial fall in prices.

But the deep state of Indian real estate (the bankers, the builders and the politicians) essentially ensured that a real bust never really came. Of course, having learnt from this, now I point out more towards the perils of owning real estate at a price you cannot really afford because that is point people looking to buy a house to live in, essentially need to understand.

Also, one can more confidently say that the real estate sector will continue to remain moribund in the days to come, than confidently predict a bust. As far as investors are concerned, the real estate story has been over for a while.

Sometimes the confidence of economists comes from the prevailing narrative. As Daniel Acemoglu and James A Robinson write in *Why Nations Fail – The Origins of Power, Prosperity and Poverty:*

> *"The most widely used university textbook in economics, written by Nobel Prize-winner Paul Samuelson, repeatedly predicted the coming economic dominance of the Soviet Union. In the 1961 edition, Samuelson predicted that Soviet national income would overtake that of the United States possibly by 1984, but probably by 1997. In the 1980 edition, there was little change in the analysis, though the two dates were delayed to 2002 and 2012."*

Of course nothing of this sort happened, and the Soviet Union broke up in December 1991. But those were the days, and the narrative framed around the success of the Soviet style of economics, driven by its Five-Year Plans, was very popular. Samuelson was not the only one to be seduced by it. In fact, an entire generation was.

Interestingly, the economist Phillip Tetlock has carried out extensive research on experts and their predictions. Gardner, from whose book I have quoted above, documents this in *Future Babble* .

As he writes:

> *"Tetlock recruited 284 experts— political scientists, economists, and journalists— whose jobs involve commenting or giving advice on political or economic trends… Over many years, Tetlock and his team peppered the experts with questions. In all,*

> *they collected an astonishing 27,450 judgments about the future."*

It turned out that the expert predictions were no more accurate than random guesses. As Gardner writes: "Experts who did particularly badly… were not comfortable with complexity and uncertainty. They sought to "reduce the problem to some core theoretical theme." This means that they had this one big idea and they stuck to it, without trying to realign their view to the new information coming in.

An excellent example of this is all the gold bulls who came out of the woodwork post the financial crisis of 2008. They talked about gold reaching very high price levels (The highest I encountered was $55,000 per ounce).

As a journalist I interviewed many such individuals and the confidence they had in their forecasts was amazing. In that round, gold didn't even touch $2,000 per ounce. But the audience lapped the interviews I did. Why? Because these experts exuded confidence in their interviews, even though they eventually turned out to be wrong.

In 2012, when I turned into a freelance writer, I exuded the same confidence on gold while writing about it. And when the prices actually started to fall, it sort of struck at a core belief I had developed over the years and it took me a couple of years to get around to the whole thing.

As Grant writes: "When a core belief is questioned… we tend to shut down rather than open up. It's as if there's a miniature dictator living inside our heads, controlling the flow of facts to our minds." This is referred to as totalitarian ego and a decade later I can see this ego among many bitcoin experts, whenever one questions the entire idea of bitcoin as money, and that has me worried.

Now getting back to Gardner and Tetlcok. Experts who did better than the average of the group that Tetlock had recruited had no template or no big idea. They tried to synthesise information from multiple sources.

As Tetlock writes: "Most of all, these experts were comfortable seeing the world as complex and uncertain—so comfortable that they tended to doubt the ability of anyone to predict the future. That resulted in a paradox: The experts who were more accurate than others tended to be much less confident that they were right."

This explains why most business TV news anchors, podcasters, YouTuber, social media influencers, etc., who are popular, sound very confident. They believe in this one big idea, which sounds sensible to people, irrespective of whether it is right in the real world or not, and they keep hammering it over and over again, to their audience.

It also explains why guys who are normally right about things aren't really popular with the media or the public at large. This is simply because they are not totally confident about what they are saying. They have their ifs and buts built into what they say and are constantly revising the information in their heads. And as and when they feel like it, they are ready to revise their views as well. This constant revision comes across as lack of confidence to the world at large. Tetlock called such experts *foxes* and experts who believed in that one big thing as *hedgehogs* .

The categorisations were from an essay written by political philosopher Isaiah Berlin, in which Berlin had recalled a small part of an ancient Greek poem. “The fox knows many things… but the hedgehog knows one big thing.” After knowing this, it is easy to figure out who is a fox and who is a hedgehog.

As Gardner writes:

> *“If you hear a hedgehog make a long-term prediction, it is almost certainly wrong. Treat it with great skepticism. That may seem like obscure advice, but take a look at the television panels, magazines, books, newspapers, and blogs where predictions flourish. The sort of expert typically found there is the sort who is confident, clear, and dramatic. The sort who delivers quality sound bites and compelling stories. The sort who doesn’t bother with complications, caveats, and uncertainties. The sort who has One Big Idea.”*

Hence, the kind of expert found in the media is the kind of expert who is more likely to be wrong. One of the key findings that emerged from Tetlock’s data was: “The bigger the media profile of an expert, the less accurate his predictions are.”

In a world filled with confident forecasts, this is a very important point that needs to be kept in mind. If we really need to make sense of the world we are in, we need to figure out who the foxes are and follow them, however mentally disconcerting it might be. The hedgehogs need to be discarded.

11 March, 2021

# India, China and the Quest for Atmanirbharta

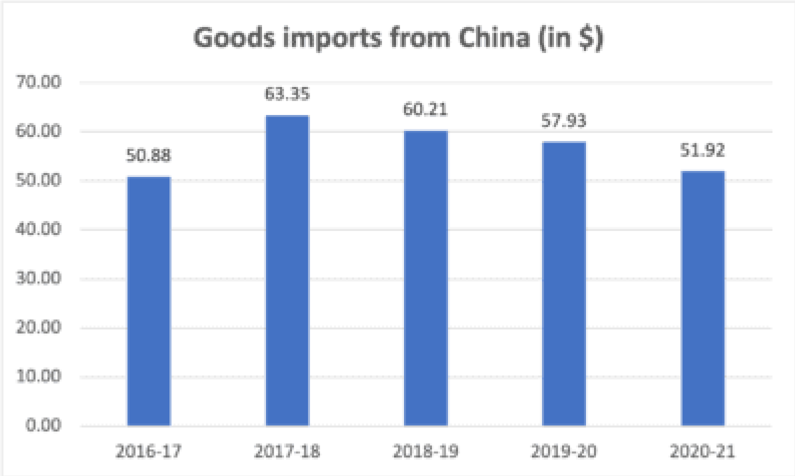
*Atmanirbharta* has been the hot political and economic buzzword in India for quite a while now. It means self-reliance in English. Or as the finance minister Nirmala Sitharaman put it in her budget speech :

> *"Atmanirbharta is not a new idea. Ancient India was largely self reliant, and equally, a business epicentre of the world. Atmanirbhar Bharat is an expression of 130 crores Indians who have full confidence in their capabilities and skills."*

In economic terms it essentially refers to import substitution, which India practiced for almost four decades, after independence, where the idea was to make everything in the country rather than import it.

In political terms, the narrative is directed towards China and our import dependence on the Middle Kingdom. In the recent past, our political tensions with our largest neighbour have escalated and we are trying to hurt it economically by producing more at home, and not importing as much from it as we had done in the past. Also, we have banned many Chinese apps.

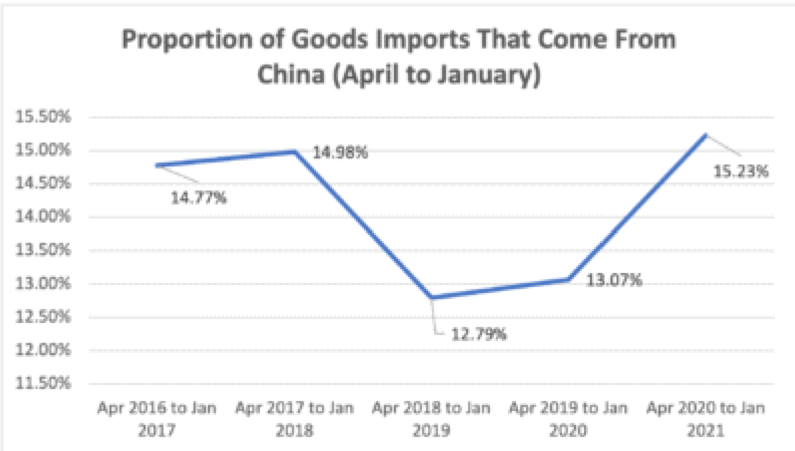
The question is where are we going with *atmanirbharta* . Let's take a look at the following chart, which plots the total amount of goods imported from China during the period April to January, over the years.




Source: Centre for Monitoring Indian Economy.

The goods imports from China during the current financial year have been the lowest between 2016-17 and 2020-21, at $51.92 billion. Nevertheless, a simple presentation of goods imports doesn't take into account the fact that India's goods imports during April 2020 to January 2021 have fallen by 23.1% to $340.9 billion. They stood at $443.22 during April 2019 to January 2020. This fall shows a lack of consumer demand, which has crashed during the course of the year, with the spread of the covid pandemic.

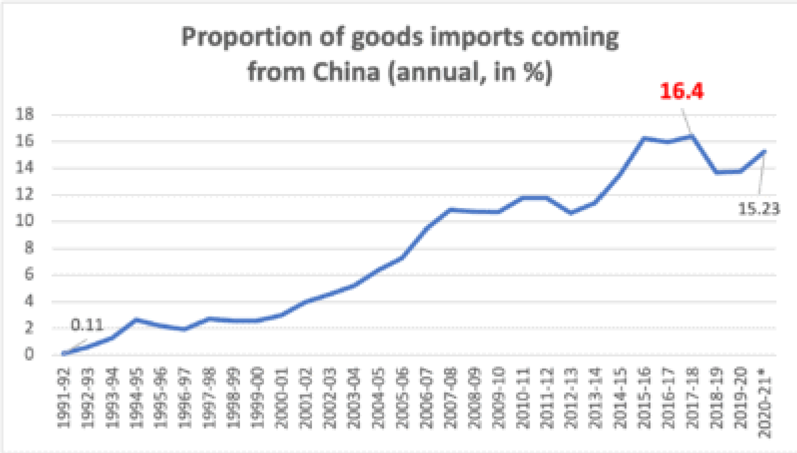
Let's look at the next chart, which plots what proportion of India's goods imports came from China, during the period April to January of a financial year, over the years.




Source: Author calculations on data from Centre for Monitoring Indian Economy.

During April 2020 to January 2021, the proportion of imports coming from China stood at 15.23%. This is the highest in the period considered. Hence, while economic and political narrative maybe moving towards *atmanirbharta* , the data clearly shows something else. Our dependence on China for goods imports continues, like it was in the past.

There is one more way we can look at data. While we don't have the full year's data for 2020-21, we do have that for the years gone by. Hence, we take a look at proportion of full-year imports coming from China, in the next chart.




Source: Centre for Monitoring Indian Economy.

*April 2020 to January 2021.

The above chart makes for a very interesting read. In 1991-92, India barely imported anything from China. Just 0.11% came from China. In the nearly three decades that have followed, the imports from China have exploded. This just shows the rise of Chinese productivity year on year, in comparison to that of India. The proportion of imports coming from China peaked at 16.4% in 2017-18, fell for the next two years, and have risen again this year.

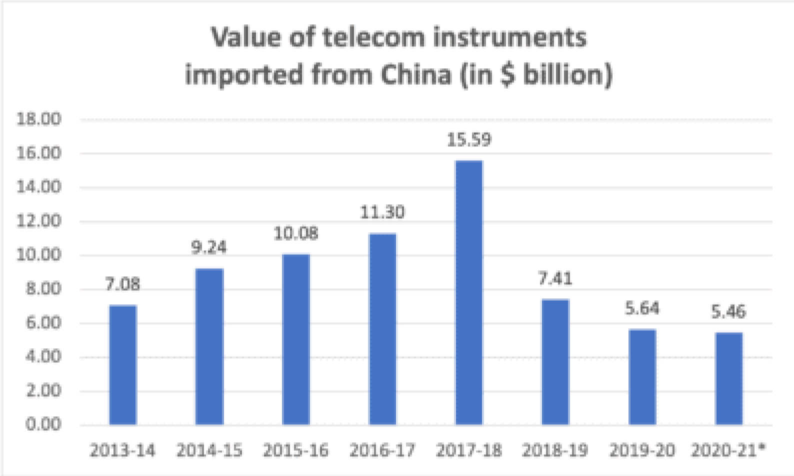
What is the reason for this marginally increased dependence in 2020-21? Ananth Krishnan writing in his terrific book *India's China Challenge – A Journey Through China's Rise and What It Means for India* , quotes Amitendu Palit, an economist at the National University of Singapore, in this context.

As Palit says: "If you look at critical medical supplies, which India has been importing for frontline healthcare workers in the Covid-19 battle, most of these come from China, which is one of the top sources, but, on the other hand, there isn't a very widely diversified source of countries from which India can actually import these either."

The larger point here is that China has now become central to many global supply chains and hence, it won't be easy for India to lower its dependence on China dramatically as far as imports of goods is concerned.

In fact, one area where India has managed to reduce its dependence on China in the last five years, is telecom instruments, as they are categorised in the imports data. Given that the use of landline phones has come down over the years, the category  primarily includes mobile handsets.

Take a look at the following chart. It plots the value of the telecom instruments (read mobile handsets) imported from China, over the years.




Source: Centre for Monitoring Indian Economy.

*April 2020 to January 2021.

As can be seen, the value of the instruments imported from China has come down over the years, though the 2020-21 full year imports are likely to end up being higher than those in 2019-20. In 2017-18, import of telecom instruments formed a little over a fifth of our imports from China. This fell to 8.67% in 2019-20 and has increased to 10.48% in the current financial year.

To make companies manufacture mobile phones in India, the government has been imposing duties/tarrifs on various goods that go into making of a mobile phone. The idea is to make imports from China expensive and in the process, force companies to manufacture phones in India.

In fact, this strategy has been borrowed from China. As Matthew C Klein and Michael Pettis write in *Trade Wars and Class Wars* : "Import substitution has succeeded thanks in part to Chinese government policies that have systematically encouraged Chinese businesses to substitute foreign production for domestic production, even when this has raised costs for Chinese consumers." Of course, unlike India, China does not need to impose duties/tariffs to "direct domestic demand towards domestic production".

As Klein and Pettis point out: "Executives can simply be told to pick Chinese suppliers over foreign ones… The result is that, unlike many other countries, imports have become less and less important to the Chinese economy since the mid 2000s."

Also, given that Indian productivity is worse than that of the Chinese, manufacturing in India, comes with a cost. While, mobile handset prices barely rose between 2015 and 2019, the same hasn't been the case in 2020, when they rose by 7%. Clearly, the cost of *atmanirbharta* on the mobile handsets front is being borne by the Indian consumer. As I keep saying, there is no free lunch, someone has got to bear the cost.

The government has also come up with the production linked incentive (PLI) scheme in order to help manufacturing companies in India. As Sitharaman said in the budget speech:

> *"Our manufacturing companies need to become an integral part of global supply*

> *chains, possess core competence and cutting-edge technology. To achieve all of the above, PLI schemes to create manufacturing global champions for an Atmanirbhar Bharat have been announced for 13 sectors. For this, the government has committed nearly Rs 1.97 lakh crores, over 5 years starting FY 2021-22. This initiative will help bring scale and size in key sectors, create and nurture global champions and provide jobs to our youth."*

There are multiple problems with this approach. The first being that the government is trying to pick winners. This entire approach smells of how things used to happen before the economic reforms of 1991, with the bureaucrats deciding what businesses should be doing.

Also, this comes at a time when prime minister Narendra Modi has been critical of IAS officers. As he said in February : "Just because somebody is an IAS officer, he is running fertiliser and chemical factories to airlines." The same *babu* is now expected to run an incentive scheme for big business.

India's biggest success stories over the last three decades, software, pharma and automobiles, happened despite the government, and not because of it. So, the idea still should be to make things easier for smaller businesses to grow bigger, which is something that happened beautifully in the IT sector. (This is not to say that the government didn't help. It did. But it *largely* didn't meddle).

In fact, while we think of China as a country with big companies that wasn't always the case. China's initial growth in the 1980s and up until the mid 1990s was through the growth of millions of Township and Village Enterprises (TVEs). This is a fact that seems to have been forgotten.

Big companies growing bigger can create some jobs, but not the number of jobs that India requires. As data from the Centre for Monitoring Indian Economy shows, in the last five years India has added 11.77 crore individuals to the working age population.

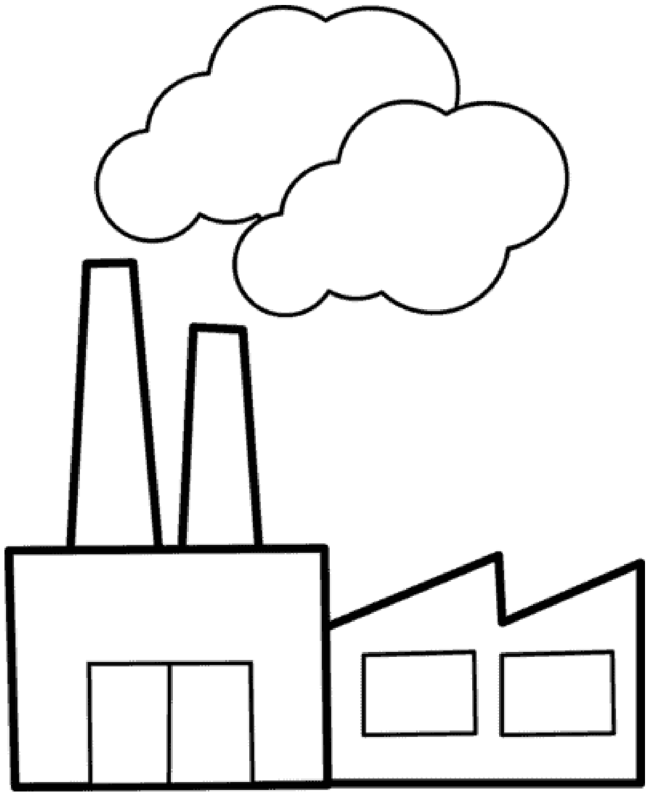
This means that around 19.76 lakh individuals have crossed the age of 15 on an average every month, over the last five years. Of course, not all of them are looking for jobs but a good chunk are. Even if we assume that around 40% of them are looking for jobs, we end up with around one crore people looking for jobs every year.

Such a huge number of jobs can only be created by small businesses growing bigger and not by big businesses growing bigger, which can only possibly be the icing on the cake.

As an OECD (Organisation for Economic Co-operation and Development) research paper points out :

> *"SMEs (small- and medium-sized enterprises) account for 60 to 70 per cent of jobs in most OECD countries, with a particularly large share in Italy and Japan, and a relatively smaller share in the United States. Throughout, they also account for a*

*disproportionately large share of new jobs, especially in those countries which have displayed a strong employment record, including the United States and the Netherlands. Some evidence points also to the importance of age, rather than size, in job creation: young firms generate more than their share of employment."'*



In fact, given the obsession the current government has had with scale and formalisation of the economy, small businesses have been hurt through a mind-numbing move like demonetisation and a half-baked goods and services tax.

Further, the globalisation game itself might be changing. While, we might want companies based out of India to become a part of global supply chains, it is worth remembering here that the strategy worked at a certain point of time.

As Krishnan writes:

> *"China was able to recognize and exploit the opportunities just as global production chains were forming through the opening of the early 1990s… The infrastructure it was able to create through the 1990s enabled 'a unique and probably unrepeatable combination of low developing country labour costs and good, almost rich country infrastructure.'"*

Also, the supply chains that are already in place are not going to shut down and move to India, just because India is now offering incentives. As Apple CEO Tim Cook said in 2017 : "The popular conception is that companies come to China because of low labour cost… The reason is because of the skill, and the quantity of skill in one location and the type of skill it is."

India clearly has a skills problem. A little more than a fifth of Indian graduates are unemployed, and at the same time when companies advertise for personnel, they can't seem to find enough of them who meet the right criteria. Multiple surveys have found Indian graduates and engineers to be simply unemployable. This is not something that can be set right overnight.

The corporates, not surprisingly, have welcomed the scheme, given that the government is offering "a recurring cash subsidy computed as a fixed percentage of the manufactured sales turnover." Hence, they clearly have an incentive to do so. In fact, lobbying has already started on this front.

Take the case of the PLI scheme in the electronics and mobile manufacturing, which has been touted as a success, after attracting investments of over Rs 11,000 crore in 2020. As an editorial in The Hindu Business Line points out, the beneficiaries are already asking for a rollover, "citing land acquisition delays, lack of skilled workforce and demand issues post Covid."

Also, as has been seen in India in the past, once a subsidy is introduced into the government's budget, it rarely goes away.

Finally, lest I be accused of looking at only negatives (honestly, please go to news.google.com and enter PLI scheme, you will only get positive stories to read), one positive thing could come out of the scheme.

As Palit told Krishnan in the context of China: "When we look at value chains today, let's say in a post Covid-19 situation, the emphasis on the part of businesses is to make these chains shorter, more resilient, more durable, and locate them closer to demand markets… This is where we often overlook the importance of China. It continues to remain a major source of final demand." And given this shifting supply chains out of China will be difficult.

This applies to India as well. Given India's size, it will continue to have a huge source of consumer demand in the years to come. This should encourage companies looking for stable supply chains to have their manufacturing bases in India to cater to its domestic market. And this is where PLI can work its magic.

As Neeraj Bansal of KPMG put it in a recent writeup :

> *"From raw materials to critical components, the COVID-19 pandemic exposed the reliance of country's key sectors on a few markets for fulfilling their manufacturing and sourcing requirements. To put things in perspective, India depends on a single market for 70 per cent of its API consumption needs, 85 per cent of smartphone components imports and 75 per cent of television components imports. As global*

> *supply chains were swiftly and effectively dismantled as one country after another went into lockdown in 2020, efforts toward bolstering domestic manufacturing gained momentum."*

Nevertheless, there is a corollary to this. As more and more people get vaccinated and the world moves on and goes back to doing things that it always has, this narrative of having manufacturing facilities closer to the demand markets, will keep getting weaker. Hence, India has a couple of years to cash in on it.

Of course, whether India emerges as a country where the products are assembled or major value addition takes place, remains to be seen. Also, prices will go up. Make in India will come at a cost.

8 March, 2021

# Revealing the Real Picture Behind India's Unemployment Problem

*BA Kiya, MBA Kiya,*
*Lagta Hai Sab Kuch Aiwen Kiya*
— With due apologies to Sampooran Singh Kalra.

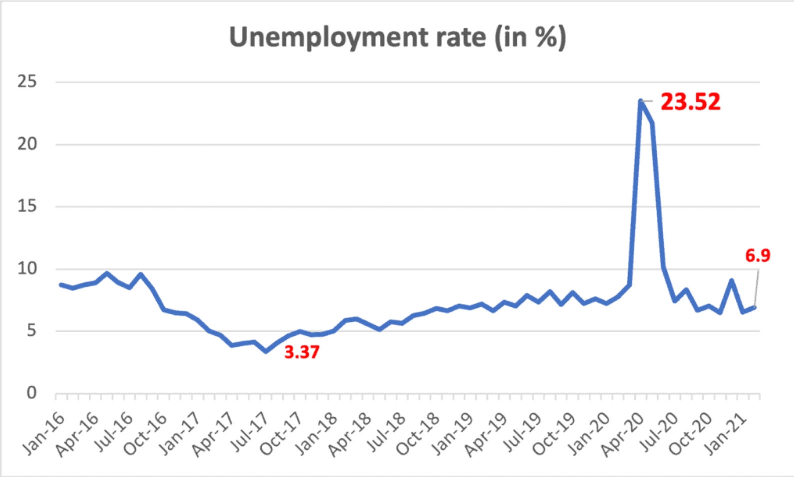
***The rate of unemployment as of February 2021 stood at 6.9%. This doesn't sound very high. But the calculation of this figure misses out on a very important nuance.***

Those who follow me on Twitter know that I go by the *moniker* of *Shikshit Berozgar* (or educated unemployed). This is basically a joke I crack on myself on not being gainfully employed with a corporate, in the traditional sense of the term.

Nevertheless, on a more serious note, unemployment is a very serious problem in India. In fact, in the recent past, *#modi_rojgar_do* has been a top Twitter trend. This gives me a reason to look into this economic and social illness which impacts the society at large and the youth in particular, very badly. Of course, *nothing is what it seems* , which is why it is important to go into details.

I will use unemployment data published by the Centre for Monitoring Indian Economy , which has now been available for a period of five years, hence, will give us a decent long-term trend.

Let's first look at the unemployment rate over the last five years, starting from January 2016 onward.




Source: Centre for Monitoring Indian Economy.

What does the chart tell us? The unemployment rate has varied quite a bit between January 2016 and February 2021. As of February 2021, the rate of unemployment stood at 6.9%. Hence, things have improved from April 2020, when the unemployment rate hit a high of 23.52% and nearly one-fourth of the labour force was unemployed. This was when the lockdown enforced by the government was at its peak.

Nonetheless, the unemployment rate is still very high in comparison to the low of 3.37%, which was achieved in July 2017. It needs to be mentioned here that the Goods and Services Tax (GST) came into effect from July 1, 2017 and has been responsible for increased formalisation of the Indian economy. Hence, many informal businesses have been shut down. Formal businesses tend to be more mechanised and hence, employ fewer people, can be one possible explanation for the higher unemployment.

Moving forward if we were to read only the above chart, we are likely to come to the conclusion that the negative economic impact of the covid pandemic and the general slowdown in the Indian economy, over the years, are gone. But there is some nuance we are missing out on here.

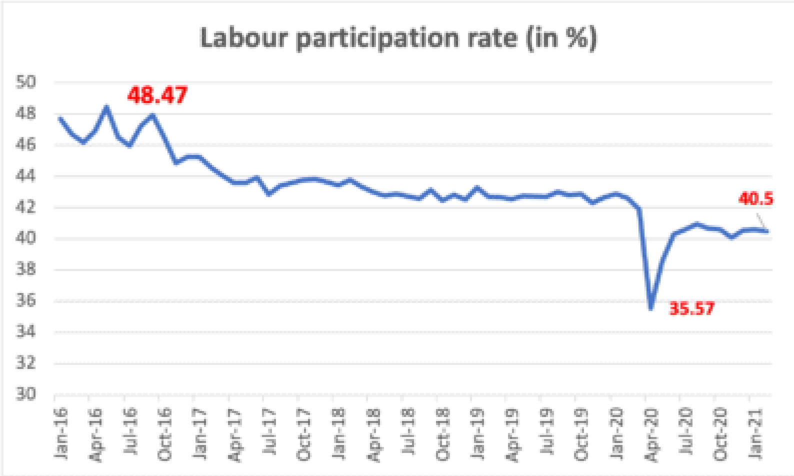
While I have shared the unemployment rate in the above chart, I haven't told you how the term unemployment is defined. A person is categorised as unemployed "because of a lack of job and where such a person is *actively* looking for a job". The word to mark here is actively. At the risk of repetition, a person can be categorised as unemployed only if he doesn't have a job and is searching for one.

As the Centre for Monitoring Indian Economy (CMIE) puts it, a person categorised as unemployed, "should be unemployed on the date of the survey, should be actively looking for a job in the 100 hundred days (approximately three months) preceding the date of the survey and should be willing to take up the job if a job is found."

They further point out: "A person is considered to be actively looking for a job if such a person has contacted potential employers for jobs, contacted employment agencies, placement agencies, appeared for job interviews, responded to job advertisements, online employment sites, made applications, submitted resumes to potential employers or reached out to family members, friends, teachers to look for jobs from them."

To put it in short, *waiting for a job offer to come, is not considered as actively looking for a job* .

It will soon become clear why have I gone into such detail trying to explain what being unemployed exactly means. First let's take a look at the following chart, which plots the labour participation rate.




Source: Centre for Monitoring Indian Economy.

In fact, this chart is at the heart of the issue of Indian unemployment. As can be seen from it, the labour participation rate has been falling over the years. It was at a peak of 48.47% in May 2016 and fell to a low of 35.57% in April 2020. In February 2021, it stood at 40.5%.

Now what does this mean? Labour participation rate is the ratio of the labour force to the population greater than 15 years of age. And what is the labour force? As per CMIE, labour force consists of persons who are of 15 years of age or more, and are employed, or are unemployed and are *actively looking for a job* .

What has happened in the last five years? Let's take the case of May 2016. In May 2016, the population greater than 15 years or what is referred to as working-age population, stood at 94.58 crore. Of this, 45.84 crore individuals formed the labour force, which means they were either employed or were unemployed and actively looking for a job. Hence, labour participation rate, which is the ratio of the labour force to the population greater than 15 years of age, was at 48.47%.

Now what's the scene in February 2021? The population greater than 15 years stood at 105.80 crore. The labour force stood at 42.85 crore. This implies a labour participation rate of 40.5%.

In simple English, in February 2021, a smaller proportion the working age population is working or is unemployed and looking for a job, than was the case in May 2016.

The working age population, between May 2016 and February 2021, has gone up from 94.58 crore to 105.8 crore, this implies an increase of 11.22 crore.

Nevertheless, the number of people employed or unemployed and looking for a job, that is the total labour force, has fallen from 45.84 crore to 42.85 crore, or by 2.99 crore.

So, *the working age population has increased by 11.22 crore between May 2016 and February 2021, but the total labour force as such has fallen by 2.99 crore* . This is India's real unemployment problem, which isn't reflected in the unemployment rate, and needs a lot more digging.

What is happening here? A very small proportion of the population is studying more and some may also be retiring early. But that hardly explains the scale of this problem. The explanation lies in the fact that more people are *simply dropping out* of the labour force, because they are not able to find jobs over a period of time and hence, are not *actively* looking for jobs anymore.

Let's look at how the situation has changed post-covid. In January 2020, before covid had struck, the working age population had stood at 103.13 crore. By February 2021, this had jumped to 105.8 crore, a jump of 2.67 crore. Meanwhile, the labour force as of January 2020 stood at 44.24 crore. It has since shrunk to 42.85 crore, by 1.39 crore. So, post-covid, the working age population has gone up by 2.67 crore, but the workforce has shrunk by 1.39 crore.

Clearly, covid has only accentuated the larger unemployment trend India was already going through. In a sense, many jobs have simply been destroyed, leading to people dropping out of the workforce and in the process, making the overall unemployment number look much better than it actually is.

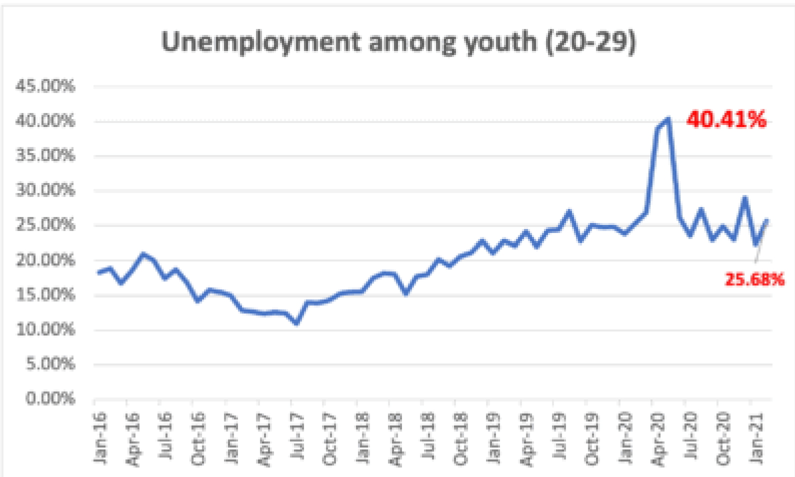
In the conventional definition of unemployment, individuals who are not actively looking for a job and drop out of the workforce, do not get counted, but ultimately, they are also not gainfully employed. And that's where the problem lies and explains hashtags like *#modi_rojgar_do* .

If you still haven't got it, let me share a very simple example. Let's say the labour force has 100 individuals. The working age population of people above 15 years of age comprises 200 individuals. Hence, the labour participation rate is 50%. Let's further assume that the unemployment rate is 10%. This means that 10 individuals are unemployed (10% of 100) and are actively looking for a job.

These individuals do not get a job for a while and let's further assume that four of them stop actively looking for a job. Given this, the labour force size will fall to 96 (100 minus 4). Those categorised as unemployed will fall to six (10 minus 4). The rate of unemployment will fall to 6.25% (6 expressed as a percentage of 96).

So, the rate of unemployment will come down from 10% to 6.25%, nevertheless, the number of people without jobs will continue to remain at 10. The labour participation rate will come down to 48% (96 expressed as a percentage of 200), from the earlier 50%.  This is how the maths will work out.  This is precisely what is happening in India, of course, at a much larger level.

Now let's take a look at the unemployment rate and labour participation rate among the youth, that is those aged between 20 and 29. This is where things get very interesting.

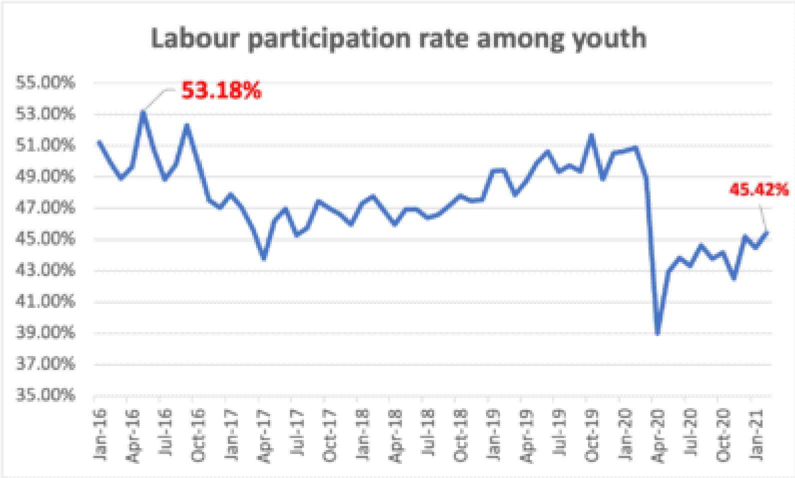



Source: Author calculations using data from Centre for Monitoring Indian Economy.

As can be seen from the above chart, the unemployment among youth, which was always on the higher side, has gone even higher, in the last five years. It peaked at 40.41% in April 2020, and in February 2021, was still at a very high rate of 25.68%.

What this means is that one in every four Indian youths is unemployed and is actively looking for a job. And that is clearly bad news. The situation has deteriorated over the last five years.

Now let's take a look at the labour participation rate among youth.




Source: Author calculations using data from Centre for Monitoring Indian Economy.

As is the overall trend, the labour force participation rate among youth has come down dramatically over the years. It peaked at 53.18% in May 2016 and in February 2021, it stood at 45.42%. Of course, one explanation for this is lies in youth spending more years in college. Nevertheless, the broader explanation for this lies in youth dropping out of the labour force given their inability to find a job. Also, even those who are in college are actively looking for a job. Or sometimes college is just an excuse to postpone actively looking for a job. These are points that need to be remembered.

What explains this situation? One reason for this lies in the fact that the investment to gross domestic product (GDP) has fallen over the years from a high of 34.31% of the GDP in 2011-12 and is expected to be at 30.91% in 2020-21. Hence, with a lower investment in the economy, fewer jobs are being created.

Over the last few years, the government has made attempts at formalizing the economy through a harebrained measure like demonetization and a half-baked measure like goods and services tax.

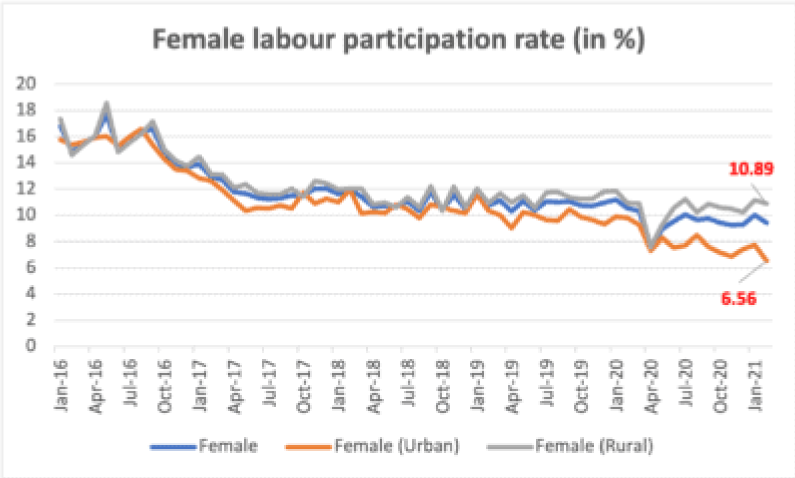
As an August 2018 Mint Street Memo published by the Reserve Bank of India points out:

> *"The MSME ( micro, small and medium enterprises) sector has witnessed two major recent shocks, viz., demonetisation and introduction of goods and services tax (GST). For instance, contractual labour in both the wearing apparel and gems and jewellery sectors reportedly suffered as payments from employers became constrained after demonetisation (RBI, 2017). Similarly, the introduction of GST led to increase in compliance costs and other operating costs for MSMEs as most of them were brought into the tax net."*

This has hit jobs badly as well.

It needs to be understood here that many employees of MSMEs that shut down did not come under the income tax slab. Nevertheless, whenever they make a purchase as a consumer, they do pay some form of indirect tax. This is a point those celebrating the increasing formalisation of the economy, seem to miss out on.

Let's take a look at a few more trends, starting with female labour participation rate.

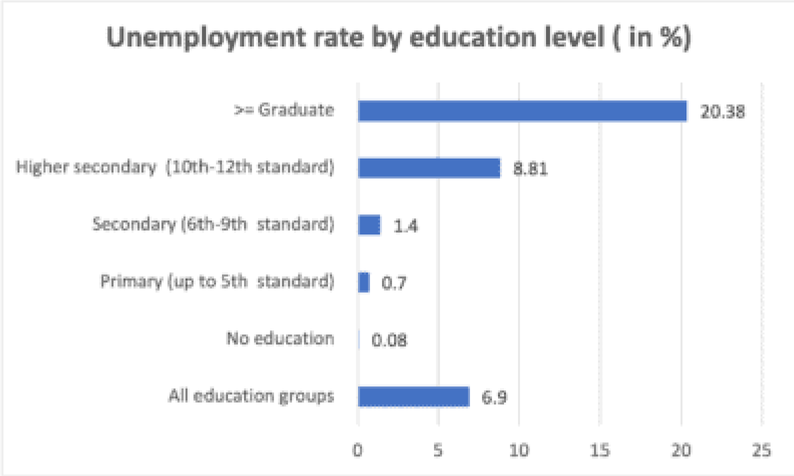



Source: Centre for Monitoring Indian Economy.

This is a very disturbing chart. The female labour participation rate has crashed to just 10.89%. In urban India, it was at 6.56% in February. This means more and more women are getting educated but are not working in salaried jobs. In fact, this is a trend that started before 2014 and it has only accentuated since then. As per surveys carried out by the Labour Bureau, the female labour participation rate in 2012-13 and 2013-14 stood at 25% and 28.7%.

Economists have struggled to come up with an explanation for this. One possible explanation lies in the fact that the number of jobs available haven't grown at the pace that could accommodate the new individuals, both men and women, entering the workforce. Hence, in a patriarchal society, men in deciding positions, have offered jobs to other men. This needs more research, and I will write about it in detail in the days to come.

Another interesting trend is the unemployment rate depending on the education level. The following chart plots the unemployment rate by level of education for February 2021.




Source: Centre for Monitoring Indian Economy.

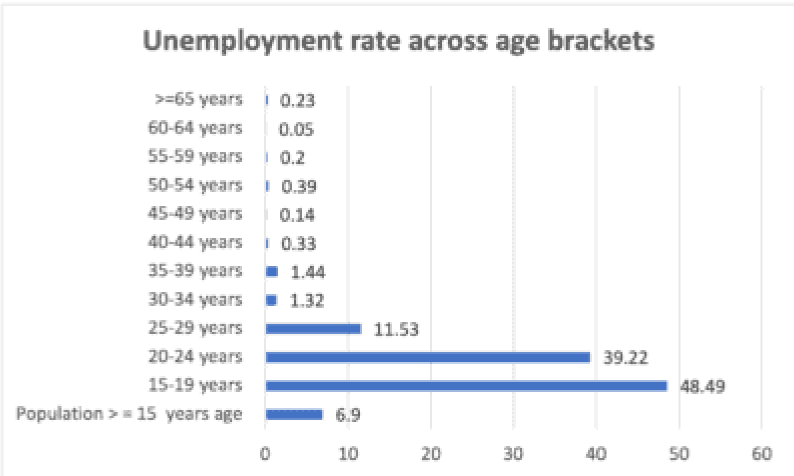
While I have only shared data for February 2021, this is a trend that has played out over the years.

World over there is a wage premium for education, which means, the more educated you are, the higher your income is likely to be. That might be the case in India as well, but along with that we have another very interesting phenomenon.

The rate of unemployment increases with the number of years of education, with one in every five graduates being unemployed. The fact many graduates are unemployed again explains the popularity of trends like *#modi_rojgar_do* . The graduates have the time, the energy and the internet bandwidth, to get such an important issue to trend.

The larger explanation for this lies in the fact that graduates tend to wait for that good job, which never really comes. That is a choice that the less educated don't make.

Let's now look at a chart which plots the rate of unemployment across different age brackets, for the month of February 2021.




Source: Centre for Monitoring Indian Economy.

The rate of unemployment is highest at the younger ages and as one ages, it comes down dramatically.

The high rate of unemployment for the ages between 15-19 can be explained by the fact that more individuals now spend time in school and go to college. But what about rates beyond that bracket?

The interesting thing is that rate of unemployment in the age category 25-29 stood at 11.53% in February 2021. For the age group, 30-34, it was at only 1.32%. While I have only shared data for February 2021, this is a trend that has played out over the years.

What's happening here? It seems this is a problem that isn't just peculiar to India and is prevalent in other parts of the world, including South Africa, Egypt and countries in the Middle East.

A part of the problem, like most disappointments in life, is a mismatch of expectations that the unemployed youth have, and the situation as it prevails.

As Abhijit Banerjee and Esther Duflo write in *Good Economics for Hard Times* :

> *"They [i.e. the youth] were told that if they studied hard they would get a good job, meaning mostly a desk job or a teaching job. This was closer to the truth in their parents' generation than it is today… The growth in government jobs slowed and eventually stopped in the face of budgetary pressures."*

In fact, in the Indian case, the pace of creation of government jobs has slowed down over the years. As far as central public sector enterprises (CPSEs) are concerned, the total number of employees has gone down over the years.

Take a look at the following table.

**Employment at CPSEs**

| Year | Employees (No. in lakh (Excl. Contract/Causal workers) | Total Emoluments (Rs. in Crore p.a) | Per Capita Emoluments (Rupees p.a) |
|---|---|---|---|
| 2009-10 | 14.90 | 87792 | 589210 |
| 2010-11 | 14.40 | 98402 | 683347 |
| 2011-12 | 14.50 | 105648 | 728606 |
| 2012-13 | 14.02 | 116363 | 830263 |
| 2013-14 | 13.49 | 122322 | 906665 |
| 2014-15 | 12.91 | 127387 | 986598 |
| 2015-16 | 11.85 | 127182 | 1072920 |
| 2016-17 | 11.35 | 140956 | 1241165 |
| 2017-18 | 10.88 | 153945 | 1415556 |
| 2018-19 | 10.33 | 152684 | 1478280 |

Source: Public Sector Enterprises Survey 2018-19.

The number of employees in 2009-10 had stood at 14.90 lakh. It has fallen to 10.33 lakh in 2018-19. This is largely true of the government as a whole. But the fascination for a government job still remains strong and there is an economic incentive for it as well.

As can be seen from the above table, while the number of jobs in CPSEs has come down, the emoluments have gone up. In 2009-10, it stood at Rs 5.89 lakh. In 2018-19, it had jumped to Rs 14.78 lakh. And this is just the emoluments. There are other things that come with a government job, employment guarantee for life, access to good medical facilities, pension in many cases, and so on.

This explains why every few months we get stories in the media about graduates, engineers, post graduates and even PhDs, applying for low-level government jobs like that of peons, sweepers etc.

As Banerjee and Duflo write:

> *"There are small fraction of jobs that are much more attractive than the rest, for the reasons having nothing to do with productivity. The best example are government jobs… In the poorest countries, public-sector workers earn more than double the average wage in the private sector. And this is not counting generous health and pension benefits."*

What this ensures is that many individuals spend the best part of their youth preparing and writing exams to get into a government job. As Banerjee and Duflo write: "These young people are mostly waiting for jobs they will not get… If the government jobs stopped being quite so desirable, the economy would gain many years of productive labour."

But given that there are very few government jobs going around at the end of the day, the futility of it all, ultimately hits individuals who cannot see a world beyond a government job. What this basically means is that as people age, they eventually do start working, once their overall expectations fall in line with what is on offer.

So, other than the fact that there aren't enough jobs going around for anyone, the love of a government job also seems to hold people back.

To conclude, you won't get to read this anywhere in the mainstream media. Hence, it is very important that you continue supporting my work .

PS: This is not to say that all was well before 2014. It clearly wasn't. As the Report on Employment-Unemployment Survey of 2013-14 points out: "Full employment was available to only 63.4 per cent of self-employed persons, the figure being as low as 42.1 among 'casual' workers." The government has done away with the publishing of this report, since then. Such big structural problems don't manifest overnight. If not tackled on a war footing, they only get worse with time and which is what seems to have happened.

4 March, 2021

# Central Banks, Helicopter Money and How Not to Spot Bubbles

The idea for this piece came after reading the latest edition of Dylan Grice's fantastic newsletter Popular Delusions . It took my mind back to some stuff I had written about, a while back, in the second volume of the Easy Money trilogy. Now what do they say about the more things change the more they remain the same?

Anyway, Grice's latest newsletter starts with a comment made by Jerome Powell, the current Chairman of the Federal Reserve of the United States, the American central bank.

As Powell said on CNBC:

> *"The big picture is still that we've seen … three decades, a quarter of a century, of lower and more stable inflation and we've seen really the last decade be characterized by global disinflationary forces and large advanced economy nations struggling to reach their 2% inflation goal from below."*

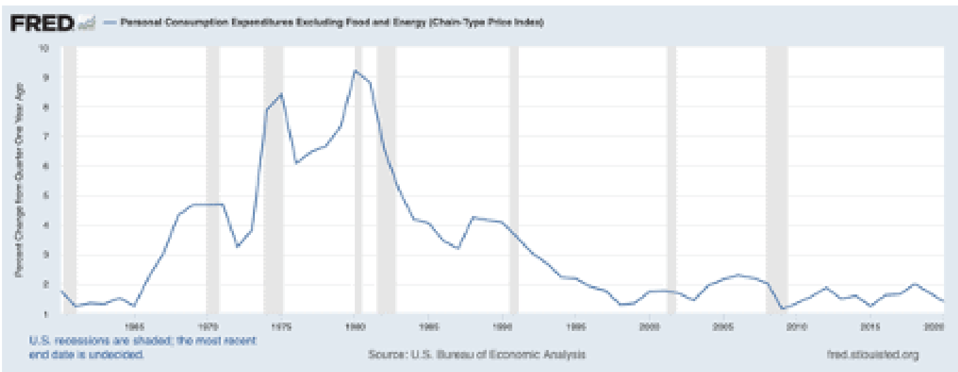
He further said:

> *"If the economy reopens, there's quite a lot of savings on peoples' balance sheets… you could see strong spending growth and there could be some upward pressure on prices. Again though, my expectation would be that that would be neither large nor sustained."*

How do we interpret the above statements in simple English?

**1)** What Powell is basically saying here is that all the money printing carried out by central banks across the world over the last decade, hasn't really led to high inflation. In fact, the inflation has constantly been less than the 2% level targeted by the Western central banks (a disinflationary environment as Powell put it).

And he is right. Take a look at following graph which basically plots inflation in the United States, as measured by the core personal expenditures index excluding food and energy. This is the index followed by the Federal Reserve when it comes to inflation.




Since 2008, the year when the financial crisis broke out, the only year in which inflation in the US touched 2%, was 2018. Clearly, the trillions of dollars printed by the Fed since then haven't led to a high inflation at the consumer level.

I clearly remember that when the Fed started printing money post the breakout of the financial crisis, many writers (including yours truly) said very high inflation was on its way as too much money would end up chasing the same amount of goods and services, and this would drive up prices. But nothing like that happened. (The good bit is that the newspaper I wrote all this in, has since shutdown. So, finding evidence of it won't be easy :-))

**2)** Powell also said that while he expects some inflation as people go back to leading normal lives once again post covid, but that's not something to worry about because it would neither be large nor sustained. Hence, Powell expects the inflation to rise and then settle down.

This leads to the question why inflation has continued to remain less than 2% all these years through much of the Western world, despite the massive amount of money printing that has been carried out.

In an essay written in 1969, the economist Milton Friedman came up with the concept of the *helicopter drop of money* . As he had written in the essay:

> *"Let us suppose now that one day a helicopter flies over this community and drops an additional $1,000 in bills from the sky, which is, of course, hastily collected by members of the community."*

The idea here was to distribute money to the public, so that they got out there and spend it, in the process creating inflation and economic growth.

The money printing carried out by the Federal Reserve and other central banks in the recent past and since 2008, was supposed to be a version of this helicopter drop. Of course, there was no helicopter going around dropping money directly to citizens, but central banks printed money and pumped that money into the financial system by buying bonds.

This was supposed to drive down interest rates. At lower interest rates people were supposed to borrow and spend, as they had before the financial crisis, and companies were supposed to borrow and expand.

The hope was that the increased spending would create some inflation and some economic growth along the way, like a helicopter drop is expected to.

The trouble with this argument is that it doesn't take a basic factor into account, which is, when the money is being dropped from a helicopter, who is standing under it. The point being that people standing under the helicopter are likely to collect the money before others do and this changes the situation.

In fact, this possibility was first observed by Richard Cantillon an Irish-French economist, who lived in the seventeenth and the eighteenth century, before the era of Adam Smith as well as helicopters. Clearly, economists of the modern world, have forgotten him, which is hardly surprising given that economists these days rarely read any history.

When central banks print money, they do so with the belief that money is neutral. So, in that sense, it does not really matter who is standing under the helicopter when the money is printed and dropped into the economy, but Cantillon showed that money wasn't really neutral and that it mattered where it was injected into the economy.

Cantillon made this observation based on all the gold and silver coming into Spain from what was then called the New World (now South America). When money supply increased in the form of gold and silver, it would first benefit the people associated with the mining industry, that is, the owners of the mines, the adventurers who went looking for gold and silver, the smelters, the refiners, and the workers at the gold and silver mines.

These individuals would end up with a greater amount of gold and silver, that is, money. They would spend this money and thus drive up the prices of meat, wine, wool, wheat, etc. Of course, everyone in the economy had to pay these higher prices. ((I came to know of this effect from Dylan Grice, after having interviewed him many years back and then starting to read his newsletter regularly).

The Cantillon effect has played out since 2008. When central banks printed and pumped money into the financial system, the large institutional investors, were the ones standing under the helicopter.

They borrowed money at cheap rates and invested across large parts across the world, fuelling stock market and bond market rallies primarily, and a few real estate ones as well.

As economist Bill Bonner put it in a 2013 column:

> *"The Fed creates new money (not more wealth … just new money). This new money goes into the banking system, pretending to have the same value as the money that people worked for. And people with good connections to the banks take advantage of the cheap credit this new money creates to aid financial speculation."*

After the large institutional investors came the corporates, who were expected to borrow money and expand, and create jobs and economic growth in the process. What they did instead was borrow money to buyback their shares.

When companies announce a decision to buyback their shares, it pushes up the possibility of their earning per share going up and this leads to higher stock prices, benefitting the top management of the company who owns company stock. Of course, the company ends up with lesser equity and more debt in the process. But that is a problem for a later date, by which time the top management would have moved on.

So, instead of consumer price inflation, what the world got was asset price inflation, with the values of financial assets, totally out of whack from the underlying fundamentals.

This dynamic has played out again since the beginning of 2020, in the post-covid world. Once the covid pandemic broke out, central banks decided to print and pump money into the financial system, like they had after the financial crisis. The US Federal Reserve has printed more than three trillion dollars and the Bank of Japan has printed more than 100 trillion yen, in the last one year.

And guess who was standing beneath the helicopter this time around? …

But along with this something else happened. The governments of the Western world also decided to send cheques directly to people, so that they could spend money directly and help boost economic activity. .

The trouble was with the pandemic on, people were stuck at homes. Hence, the money got saved and invested. Along with the institutional money, retail money also flowed into financial markets all across the world.

This has sent prices of financial assets soaring. As of March 2, the total market capitalization of the US stock market stood at 191.5% of its gross domestic product. The long term average of this ratio is 85.55%.

As Grice puts it in his latest newsletter:

> *"As the stock market makes new all-time highs… The IPO market is hot, credit markets are hot, commodity markets are hot, the crypto markets are hot. Everything, it seems is hot."*

Of course, other than the inflation as the Fed likes to measure it, which continues to be under 2%. And given that, all is well.

In every era when the prices of financial assets go up substantially, people forget history. This is not the first time that the Fed and other central banks are ignoring financial inflation and looking only at consumer price inflation.

Something similar happened both before the dotcom and telecom bubble, which burst in 2000 and 2001, and the sub prime and real estate bubble, which burst in 2007 and 2008. The Fed kept ignoring the bubbles while waiting for the inflation to cross 2%. This time is no different. (For details you can refer to the third volume of the Easy Money trilogy).

Inflation targeting as a policy, worked when inflation was high and central banks wanted to bring it down. This happened right through the 1980s and the first half of the 1990s.

Since the mid-1990s, inflation has been low in much of the Western world thanks to Chinese imports and outsourcing. As Niall Ferguson writes in *The Ascent of Money – A Financial History of the World* : "Chinese imports kept down US inflation. Chinese savings kept down US interest rates. Chinese labour kept down US wage costs."

This has led to inflation targeting being used in reverse. Instead of trying to control inflation, Western central banks have been trying to create it, using the same set of tools.

As Gary Dugan, who was the CIO, Asia and Middle East, RBS Wealth Division, told me in a 2013 interview :

> *"We got inflation which was too low. So, we have changed it all around to actually try to create inflation, rather than to dampen it. I don't think they know what tools they should be using. The central banks are using the same tools they used to dampen inflation, in a reverse way, in order to create it. And that is clearly not working."*

What was true for 2013 is also true for 2021. The playbook of central banks continues to remain the same. As I wrote in a recent piece for the Mint , the whole situation reminds me of the Hotel California song, where The

Eagles sang, *you can check out any time you want but you can never leave.*

The trouble is that along with the money printing there is something else at play this time around. A large part of the global population has been stuck at their homes for more than a year. As they get vaccinated and start living normal lives again, a huge amount of pent-up demand is going to hit the market .

This might lead to inflation as the bond market investors have been fearing for a while, given that supply is not expected to keep up with demand. A higher inflation will mean higher interest rates, something which is not good for the stock market as a whole.

But there is another important factor that needs to be kept in mind. People will be spending their savings . And this means that they will be cashing in on their investments, be it stocks, bitcoin or whatever.

The greater the pent-up demand that hits the market, the higher will be the savings that will be cashed out on and more will be the pressure on the financial markets.

This is an important dynamic that investors need to keep in mind this year.

3 March, 2021

# Bihar's APMC Story Does Not Inspire Much Confidence

*This is the third piece in the agriculture reform series. You can read the first two pieces here and here . While this piece stands on its own, for a better context on the overall issue, it makes sense to read the two pieces published earlier, before reading this piece.*

**Chintan Patel and Vivek Kaul**

The Farmers' Produce Trade and Commerce (Promotion and Facilitation) Act 2020 became a law on September 27, 2020. It is one of the three farm laws passed by the Modi government that has been met by stiff opposition from farmers. The law *supposedly* creates a mechanism allowing the farmers to sell their farm produce outside the Agriculture Produce Market Committees (APMCs).

As we pointed out in an earlier article , the fate of the APMCs or mandis, under the new laws is a topic of much debate. Proponents of the bill claim that allowing farm trade outside the APMCs will encourage competition and help farmers get better prices for their produce. The idea being that there will be more competition for agriculture produce and in the process, farmers will make more money. QED.

Farmer organizations opposing the bill argue that unregulated transactions outside the APMCs will actually result in a price squeeze for the farmers, given the asymmetry or the huge difference of negotiating power between the individual farmer and corporate-backed buyers. As is often the case, both sides can lay claim to a logically coherent argument backed by economic theory. So, which argument has higher odds of manifestation?

When the future is uncertain, the past is often a reliable guide. Using that rationale, it is instructive to look deeper at the Bihar experience vis-a-vis APMC markets. Bihar had done away with APMC markets in 2006. But before we get into the specifics, let's zoom out a little and take a look at the bigger picture first.

## Bihar's Backdrop

Bihar is India's poorest state. Given below are tables that chart the per capita income of India's richest and poorer states.

### Richest states in India

| State | NSDP (Net State Domestic Product) per capita (in rupees at current prices) | |
|---|---|---|
| | 2019-20 | 2018-19 |
| Goa | - | 430,081 |
| Sikkim | 425,656 | 380,926 |
| Delhi | 389,143 | 358,430 |
| Haryana | 264,207 | 236,147 |
| Karnataka | 231,246 | 212,477 |

Created with Datawrapper

**Source: https://statisticstimes.com/economy/india/indian-states-gdp-per-capita.php**

### Poorest states in India

| State | NSDP (Net State Domestic Product) per capita (in rupees at current prices) | |
|---|---|---|
| | 2019-20 | 2018-19 |
| Meghalaya | 92,174 | 84,725 |
| Assam | - | 82,837 |
| Manipur | - | 75,226 |
| Jharkhand | 79,873 | 73,155 |
| Uttar Pradesh | 70,419 | 66,512 |
| Bihar | 46,664 | 40,982 |

Created with Datawrapper

**Source: https://statisticstimes.com/economy/india/indian-states-gdp-per-capita.php**

As the above tables show, Bihar has the lowest per capita income in the country. It is about 18 percent of the income of Haryana and less than 10 percent of the income of Goa. Ironically, Bihar is endowed with abundant natural resources, especially fertile soil and groundwater, and yet it continues to remain one of the poorest states in the country.

The state has a population of 11.52 crore (2016), with a very high population density of 1,218 per square km as compared to the national average of 396 per square km. It is largely an agrarian rural economy with approximately 88.5 percent rural population out of which 74 percent of the workforce is reliant on the agriculture sector for a livelihood as per the 2011 Census.

Even accounting for shifts in the economy away from agriculture and migration out of rural areas since the last Census, the poverty in Bihar is closely linked to state of its farmers.

The high population density is clearly reflected in the land holding pattern in Bihar. Compared to other states, Bihar has highly fragmented landholdings. As the same piece of land has got divided among more and more family members over the generations, the average holding has fallen dramatically. Even though quite a few migrate to the cities, they still keep their farmland. This also stems from the fact that selling agricultural land in India is not easy.

As the table below indicates, marginal holdings of less than one hectare (around 2.47 acres) constituted about 91.2 percent of all land parcels in 2015-16, compared to the national average of 68.5 percent. Additionally, 97 percent of all holdings are  less than 2 hectares in Bihar. This high skew towards small land holdings is an important statistic, as agricultural marketing policies affect small and marginal farmers differently from those with larger holdings.

**Land holdings in Bihar.**

**Table 3.4: Distribution of Operational Holdings and Average Size of Operated Area**

| State | 2005-06 | | 2015-16 | |
|---|---|---|---|---|
| | Bihar | All India | Bihar | All India |
| **Operational Holdings (%)** | | | | |
| Marginal (<1.0 ha) | 89.64 | 64.77 | 91.21 | 68.52 |
| Small (1.0-2.0 ha) | 6.67 | 18.52 | 5.75 | 17.69 |
| Semi-medium (2.0-4.0 ha) | 2.99 | 10.93 | 2.52 | 9.45 |
| Medium (4.0-10.0 ha) | 0.67 | 4.93 | 0.49 | 3.76 |
| Large (> 10.0 ha) | 0.03 | 0.85 | 0.02 | 0.57 |
| All sizes | 100 | 100 | 100 | 100 |
| **Average size of operated area (ha)** | | | | |
| Marginal (<1.0 ha) | 0.25 | 0.38 | 0.25 | 0.38 |
| Small (1.0-2.0 ha) | 1.25 | 1.38 | 1.25 | 1.41 |
| Semi-medium (2.0-4.0 ha) | 2.59 | 2.68 | 2.60 | 2.70 |
| Medium (4.0-10.0 ha) | 5.16 | 5.74 | 5.29 | 5.72 |
| Large (> 10.0 ha) | 20.56 | 17.08 | 14.48 | 17.10 |
| All sizes | 0.43 | 1.23 | 0.39 | 1.08 |

*Source:* Agricultural Census, Ministry of Agriculture and Farmers' Welfare

## APMC Abolishment in Bihar

In 2006, the Nitish Kumar state government made the decision to abolish its state-level APMC Act allowing private players to directly purchase agricultural produce from farmers. Under the erstwhile Bihar APMC Act, both farmers and buyers would pay 1 percent of the sale price to municipal bodies. After the APMCs were abolished, the government introduced Primary Agriculture Credit Societies (PACS). PACS are panchayat level cooperatives with farmer members that fulfil 3 roles in Bihar.

**1)** Help farmers borrow money for buying farm equipment, farming inputs such as seeds, fertilizers, etc., or to tide through losses. PACS in turn are given credit by cooperative banks which are funded by the state government.

**2)** A one-stop shop for high-quality seeds, fertilisers, and other inputs.

**3)** Most importantly, PACS are responsible for procurement of grains particularly rice-paddy and wheat from the farmers at the government-announced minimum support price (MSP). Thus, PACS act as an intermediary between the farmers and the eventual purchasers of wheat and rice – which can be any of the following; Food Corporation of India (FCI), state procurement agencies or private mills, for that matter. For other produce (other than rice and wheat), farmers interact directly with private traders.

Upon procurement of the crop, especially in the case of paddy, it goes to the Bihar State Food and Civil Supplies Corporation, and then on to the Food Corporation of India, who direct it to the Public Distribution System or ration shops as they are more popularly known. The payment is expected to reach the farmer within 48 hours of selling the crop at PACS.

It should be noted that PACS exist nationwide and have long been a part of the cooperative banking system in India, formed to provide credit to rural areas. Bihar however is unique in that it expanded the scope of PACS to b) and c) above. As we shall see later in the article, PACS have not been able to deliver effectively on these objectives.

The deregulation of agriculture market transactions in Bihar in 2006 shares significant similarities with the Farmers' Produce Trade and Commerce (Promotion and Facilitation) Act 2020 . Although the central law does not call for the closure of state APMCs or creation of PACS-like entities, the core idea of deregulating agriculture trade outside of APMCs is the same.

Thus, there is merit in examining the outcomes of what has happened in Bihar over the last decade and a half, to form expectations from the new law.

Several leaders of the Bhartiya Janata Party including prime minister Narendra Modi and other supporters of the new laws have touted Bihar's abolition of APMCs to make their case. At the same time, critics have invoked Bihar as a cautionary tale of deregulating agriculture market. So, the same scenario is being presented to suit diametrically opposite arguments.

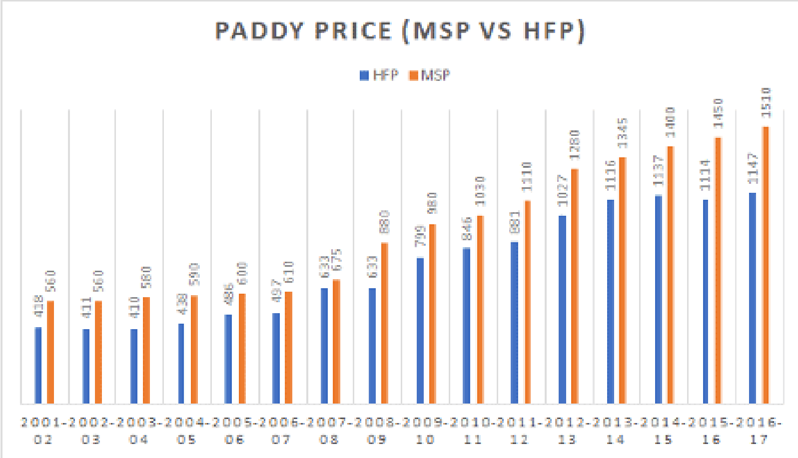
What gives? As is often the case, the truth lies somewhere in between two extremes.

Prices

The bane of Indian agriculture is the price difference between the first transaction – what the farmer gets for a commodity, and the last transaction – what you and I pay for the same commodity.  Any changes to agricultural markets like the abolition of APMCs in Bihar needs be assessed against its impact on prices.

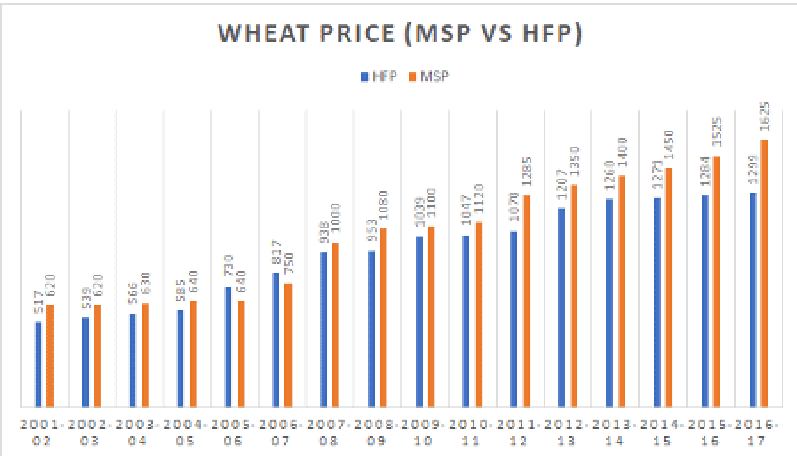
The government recognizes the importance of collecting data on prices. Each year, the Ministry of Agriculture and Farmers Welfare publishes data on farm gate prices based on data received from the state governments “to facilitate fine-tuning of agriculture policies aimed at farmer welfare” .

The average wholesale price of a commodity (e.g. wheat, rice, etc.) at which the farmer sells to a trader at the village site during the specified marketing period after the harvest of each commodity, is termed as the Farm Harvest Price (FHP) for each commodity.  The next few charts track both the FHP and MSP of four commodities (paddy, wheat, maize, and ragi) from 2000- 2017. The central government announces MSPs for 23 agricultural crops during the course of any year, but primarily buys only rice and wheat directly from farmers.



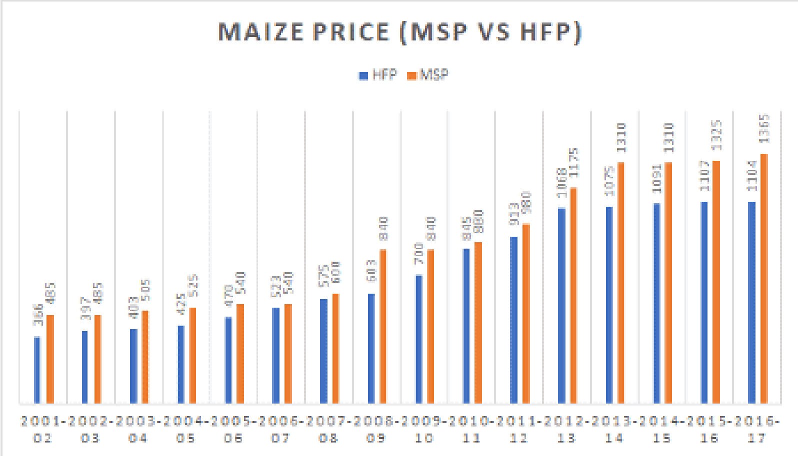

**Source: https://eands.dacnet.nic.in/**

The above chart shows that for rice paddy, the MSP has always been higher than the FHP. From 2001-02 to 2006-07, the average difference between MSP and FHP was around 26 percent. This basically means that the FHP was 26 percent lower than the MSP on an average. From 2006-07 to 2014-15, the average difference reduced to around 18 percent. 2015-16, onwards the difference has inched up to around 24 percent, for the last two years for which the data is available.



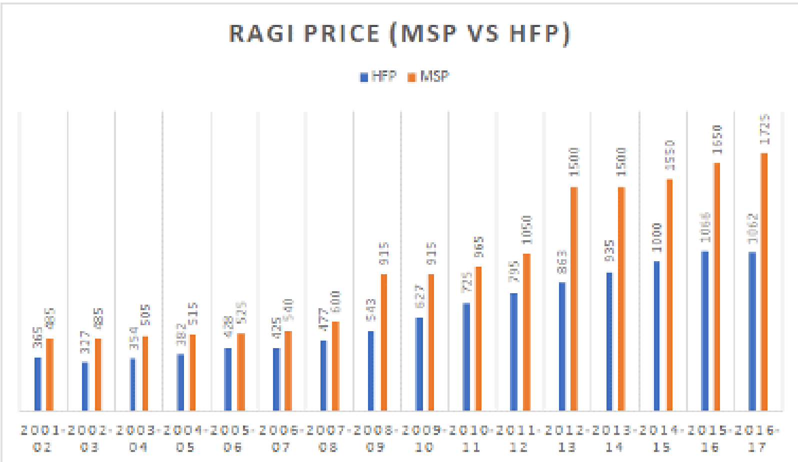

**Source: https://eands.dacnet.nic.in/**

For wheat, the difference between MSP and FHP has been less stark than that for rice paddy. From 2001-02 to 2006-07, the average difference between MSP and FHP for wheat was around 7 percent. From 2006-07 to 2014-15, the average difference barely moved up to around 8 percent . However, for the last two years 2015 to 2017, for which data is available, the difference has spiked to around 17 percent.




**Source:** **https://eands.dacnet.nic.in/**

For maize too, the difference between MSP and FHP has been less stark than for paddy but higher than that of wheat. From 2001-2 to 2006-07, the average difference between MSP and FHP for wheat was around 19 percent. From 2006-07 to 2014-15, the average difference reduced to around 12 percent . However, for the last two years 2015 to 2017, the difference has spiked to around 18 percent **.**




**Source:** **https://eands.dacnet.nic.in/**

Finally, for ragi, the difference between MSP and FHP has been quite high and has kept increasing. From 2001-02 to 2006-07, the average difference between MSP and FHP for ragi was around 26 percent. From 2006-07 to 2014-15, the average difference increased to around 31 percent. Finally, for the last two years, 2015 to 2017, the difference has increased to around 37 percent.

The following table summarises the data from the above four charts.

**Price Trends Summary**

**Difference between FHP and MSP (in %)**

| Crop | Paddy | Maize | Ragi | Wheat |
|---|---|---|---|---|
| 2001-06 | -25.21 | -18.98 | -26.3 | -6.87 |
| 2007-14 | -18.37 | -11.86 | -30.97 | -7.86 |
| 2015-17 | -23.61 | -17.79 | -36.91 | -17.93 |

Created with Datawrapper

**Source: https://eands.dacnet.nic.in/**

What can we infer from the above charts. Let's take a look pointwise.

**1)** The span from 2001 to 2017 can be divided into three periods : 2001-06, 2007-13, and 2015-17. Farm prices improved for paddy in the second period (around 18 percent lower than the MSP) compared to the first period (around 25 percent lower than the MSP). Of course, they were lower than the MSP during both the periods.

Similarly maize prices improved in the second period (around 12 percent lower than the MSP) from the first period (around 19 percent lower than the MSP). Of course, they were lower than the MSP during both the periods.

For wheat, difference between the farm prices relative to MSP stood at 7 percent during the first period and at 8 percent during the second period. Hence, the difference increased though marginally.

Rice, wheat and maize are the three major cereals produced in Bihar and make up for 80 percent of the cropping area. The difference in prices between the FHP and the MSP, largely came down in the seven year period after the removal of the state level APMC Act. This finding weakens the argument that market deregulation will *necessarily* lead to lower prices, even though the farmers did not get the MSP.

**2)** As can be seen from the above table, starting in 2015, difference between FHP and MSP has increased for all the four commodities. Let's take the case of maize. Between 2007 and 2014, the difference had stood at around 12 percent. It has since jumped to around 18 percent, almost back to pre-2006 levels.

A similar trend can be seen for the other three crops as well.

The official government data is only available till 2017, but this divergence between FHP and MSP is also reported in recent articles discussing the farmer situation in Bihar.

An article from People's Archive of Rural India on Feb 20, 2021 reports that "In 2019, a farmer sold his stock of raw paddy at the rate of Rs. 1,100 per quintal – this was 39 percent less than the MSP (minimum support price) of Rs. 1,815 at that time".
Another article from December 2020 reports that "Paddy has sold for Rs 900-1,000 a quintal in Bihar, almost half the Rs 1,868 fixed by the Centre as MSP".

The farm prices at which farmers sell continue to be depressed compared to the MSPs and given that difference has only increased in recent years, weakens the argument forwarded by supporters of the new farm laws which extrapolates deregulation to improved price realization for farmers. Economic theory doesn't always fall in line with things actually happening on the ground.

A key underlying rationale behind dismantling of the APMCs in Bihar was that it would lead to an increase in the number of buyers in the marketplace. A similar argument is also being made in the case of the new farm laws. However, that is not how things have worked out, in markets across Bihar.

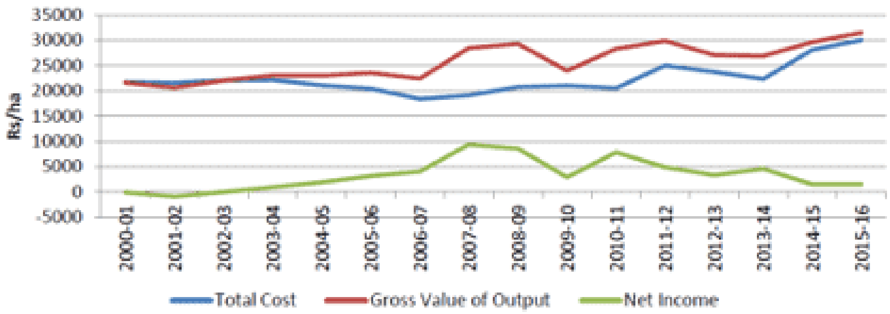
In fact, anecdotal evidence from newsreports emanating from Bihar suggests that sales to private traders are often distress sales since farmers don't have access to a sizeable pool of local buyers .

A 2019 paper by the National Council of Economic Research makes a similar observation: "Despite the abolition of the Agricultural Produce Market Committee (APMC) Act in 2006, private investment in the creation of new markets and strengthening of facilities in the existing ones did not take place in Bihar, leading to low market density. Further, the participation of government agencies in procurement and the scale of procurement of grains continue to be low. Thus, farmers are left to the mercy of traders who unscrupulously fix lower prices for agricultural produce that they buy from farmers.."

Of course, there are other reasons that push farmers to make these distress sales such as a deficient transport network, poor storage facilities, and lack of capital. All of these are exacerbated for small and marginal farmers who form the bulk of agriculturists in Bihar. Given these harsh conditions, it is unsurprising that farmers are unhappy with the present system.

The disillusionment of the Bihar farmer can also be understood looking at incomes of farmers, because ultimately the proof is in the pudding.

**Income of Farmers in Bihar**




**Source: Study on Agricultural Diagnostics for the State of Bihar in India, 2019 report by NCAER**

The above chart shows that while the net income of farmers in Bihar rose from 2007 to 2010, nevertheless, it has been declining continuously since 2010, up to the point we have data for. The declining income is explained by a rise in costs of agriculture inputs (seeds, power, labour, fertilizers, cost of finance, etc.) without a commensurate increase in sales revenue. The net income per hectare farmed, has moved alarmingly towards zero.

## Government procurement of foodgrains

Farm prices and farmer incomes are significantly affected by the level of government procurement of foodgrains in Bihar. The Central Government extends price support to paddy and wheat through the Food Corporation of India (FCI) and state procurement agencies across the country.

As per this policy, state governments are supposed to purchase paddy and wheat (conforming to certain specifications) from farmers at the declared MSP. Farmers have the option to sell their produce to private traders if they can get better prices in the open market. The objective of foodgrains procurement by government agencies is to ensure that farmers get remunerative prices for their produce and do not have to resort to distress sale. The central government accepts the responsibility to fund the procurement operations.

The next two tables give a breakdown of foodgrain procurement in the recent few years for major rice and wheat producing states.

**State wise FCI Procurement of rice-paddy**

| States (in lakh metric tonnes). | 2016-17 | | 2017-18 | | 2018-19 | | 2019-20 | |
|---|---|---|---|---|---|---|---|---|
| | Production | Procurement | Production | Procurement | Production | Procurement | Production | Procurement |
| ANDHRA PRADESH | 75 | 37 | 82 | 40 | 82 | 48 | 86 | 55 |
| TELANGANA | 52 | 36 | 63 | 36 | 67 | 52 | 73 | 75 |
| ASSAM | 47 | 0 | 53 | 0 | 52 | 1 | 51 | 2 |
| BIHAR | 82 | 12 | 81 | 8 | 62 | 9 | 61 | 13 |
| CHHATISGARH | 80 | 40 | 49 | 33 | 65 | 40 | 65 | 52 |
| HARYANA | 45 | 36 | 45 | 40 | 45 | 39 | 48 | 43 |
| JHARKHAND | 38 | 1 | 41 | 1 | 29 | 2 | 32 | 3 |
| ODISHA | 83 | 36 | 66 | 33 | 77 | 44 | 80 | 48 |
| PUNJAB | 116 | 111 | 134 | 118 | 128 | 113 | 118 | 109 |
| UTTAR PRADESH | 138 | 24 | 133 | 29 | 155 | 32 | 155 | 38 |
| WEST BENGAL | 153 | 19 | 150 | 17 | 162 | 20 | 156 | 18 |

**Source: Food Corporation of India.**

**State wise FCI procurement of wheat**

| States (in lakh metric tonnes). | 2017-18 | | 2018-19 | | 2019-20 | | 2020-21 | |
|---|---|---|---|---|---|---|---|---|
| | Production | Procurement | Production | Procurement | Production | Procurement | Production | Procurement |
| PUNJAB | 164.41 | 117.06 | 178.3 | 126.92 | 182.62 | 129.12 | 175.68 | 127.14 |
| HARYANA | 115.47 | 74.32 | 107.65 | 87.84 | 125.74 | 93.2 | 118.76 | 74 |
| UTTER PRADESH. | 300.56 | 36.99 | 318.79 | 52.94 | 327.41 | 37 | 325.86 | 35.77 |
| MADHYA PRADESH | 179.39 | 67.25 | 159.11 | 73.13 | 165.21 | 67.25 | 196.07 | 129.42 |
| RAJASTHAN | 89.85 | 12.45 | 93.69 | 15.32 | 100.83 | 14.11 | 109.16 | 22.25 |
| BIHAR | 51.11 | | 61.04 | 0.18 | 64.66 | 0.03 | 58.96 | 0.05 |

Created with Datawrapper

**Source: Food Corporation of India.**

Procurement of paddy in Bihar is around 20 percent of the state's total production, and that of wheat is almost negligible (less than 1 percent). Compare this to Punjab and Haryana, where procurement levels for paddy are over 80 percent and that of wheat are over 60 percent. This is primarily because of historical reasons, in order to promote the green revolution in the states.

This is one of the reasons for the disparity of wealth between Bihar and the other states. Since government buys paddy and wheat at MSP rates, low levels of government procurement in Bihar negatively impact the FHP for wheat and paddy, and in the process farmer incomes.

If the government purchased 100 percent (hypothetically speaking) of the paddy grown in the state, the FHP for paddy would more than likely be the same as the MSP. At 2016-17 prices, that would mean the farmer would get Rs 1,510 per quintal instead of Rs 1,147 per quintal for paddy – an increase of around 32 percent or Rs 363 per quintal. This additional revenue would directly pass-through as added income for farmers. This explains why procurement at MSP rates is a pressing demand by farmers during any policy debates on improving farmer incomes.

Low procurement of foodgrains by the state of Bihar can be attributed to two main reasons: a) inadequate funding by the state and b) Poorly functioning PACS.

There are several deficiencies in how PACS operate including restrictive registration requirements which limit who can sell to PACS, limited windows of procurement, sub-optimal timing of procurement, rejection of crop by the PACS due to excessive moisture content, and excessive delays in payment. In fact, the number of PACS in Bihar has declined by over 82 percent, from 9,035 in 2015-16 to 1,619 in 2019-20.

While the specific problems of PACS are less relevant to the national debate on the farm bills, they point to an important fact. The success or failure of market deregulation is highly dependent on the alternate systems that emerge in that environment, which will be unique for each state. Hence, the "vocal for local" mantra should also be applied when implementing policy solutions that strengthen federalism over a one solution-fits-all approach.

**Conclusions**

**1)** The so-called opening up of the agriculture market in Bihar to private players has not fundamentally altered the state of the Bihari farmer. The data on farm prices and farmer incomes is mixed after dismantling the APMCs. The difference between FHP and MSP for commodities like paddy and maize did decrease after APMCs were abolished, but those gains have reversed since 2015. The lived experience of farmers as reported by ground reports and the data on farmer incomes and prices paint a grim picture.

**2)** The PACS created by the state government for procuring food-grains have proven to be inefficient and non-responsive to farmer needs.

**3)** The government procurement at MSP continues to be a key contributing factor in improving FHPs and farmer incomes. This underlines why MSPs continue to be a key issue for farmers protesting the new farm laws.

**4)** The Bihar experiment is pertinent to the 2020 Farm Laws, but extrapolating the outcomes in Bihar to the current farm law debate needs some nuance. The data can be presented selectively, both by opponents and proponents of the farm laws to further their argument. But based on the analysis presented here, it is clear that deregulating agriculture markets in Bihar, did not cause prices to crash, though the difference with the MSPs has risen in the recent years. Neither did it usher in a wave of private buyers vying for agriculture produce, buoying up farmer incomes and prosperity in its wake.

It must be noted that the total output of an agrarian economy is affected by a host of factors including crop yield (how much crop is produced per unit area), land usage (how much area is used for cropping), cropping patterns (choice of high-value vs low-value agricultural produce), and prices . Of these, only prices are affected by the new law.

The other factors are influenced by variables such as irrigation, power availability, fertilizer usage, seed quality, rainfall, weather events, mechanization, among others. In a 2017 paper on agriculture in Bihar, the authors identify the following factors as drivers of agricultural growth. These are, irrigation, flood protection, energy for agriculture, roads, procurement system and agriculture markets.

While government policy has a role to play in shaping some of these variables, Bihar's APMC abolishment law in 2006 and the central laws in 2020, are limited to procurement and agriculture markets. Thus, commentary correlating the abolishment of APMCs in 2006 with changes in macroeconomic metrics in Bihar such as total agricultural output or agricultural growth is disingenuous.

*PS: Such a detailed data dive takes a lot of time and effort and you won't see it anywhere in the mainstream media. Given this, our work needs your constant financial support.*

1 March, 2021

# Bitcoin Without Monetary Ambition is Just Another Ponzi Scheme


There has been a lot of talk around the government banning bitcoin and other cryptocurrencies.

In fact, as the finance minister Nirmala Sitharaman recently told the Rajya Sabha : ""A high-level Inter-Ministerial Committee (IMC) constituted under the Chairmanship of Secretary (Economic Affairs) to study the issues related to virtual currencies and propose specific actions to be taken in the matter recommended in its report that all private cryptocurrencies, except any virtual currencies issued by state, will be prohibited in India."

There is no scope for confusion in this statement. It's saying that the government is gearing up to ban all cryptocurrencies including bitcoin. The only cryptocurrencies it will allow are those issued by it. (A government issuing a cryptocurrency is a joke, but then let me not go there for the time being. We will tackle it as and when it happens).

If bitcoin and other cryptocurrencies are banned by the government then all the bitcoin brokers through which investors trade, will need to shut down. Hopefully, the government will allow investors some sort of an exit option.

Of course, if you are trading bitcoin through a broker then you are speculating and do not really believe in the philosophy with which bitcoin was designed and launched (even if you think you do).

Satoshi Nakamoto, the creator (or creators for that matter, given that we don't know), didn't like the ability of the government and the central banks to create paper money out of thin air by printing it (or creating it digitally for that matter).

As he wrote on a message board in February 2009: "The central bank must be trusted not to debase the currency, but the history of fiat currencies is full of breaches of that trust. Banks must be trusted to hold our money and transfer it electronically, but they lend it out in waves of credit bubbles with barely a fraction in reserve."

This happened in the aftermath of the financial crisis that broke out in September 2008, after which the Western central banks started printing massive amounts of money to drive down interest rates, in the hope of people and businesses, borrowing and spending money, in order to revive their respective economies.

Nakamoto looked at a central bank's ability to debase paper money (by creating it out of thin air), as an abuse of the trust people had in it. And Bitcoin was supposed to be a solution for this breach of trust; a cryptocurrency which did not use banks or any third party as a medium and the code for which has been written in such a way that only 21 million units can be created.

The moment you are using a broker to buy bitcoin, you become a part of the conventional financial system and you really don't remain anonymous anymore as was the idea originally.

A few bitcoin believers who have interacted (a fairly euphemistic word) with me on the social media have told me that there are ways of continuing to buy and sell bitcoin, even if the government bans them. So, they are really not perturbed by the idea of the government banning bitcoin.

The trouble with this argument is that if you continue to trade bitcoin after the ban, you are breaking the law. You might feel that the law isn't fair, but a law is a law. One way of continuing to trade bitcoin is to legally move money abroad (up to a limit of $2,50,000) and use that money to trade bitcoin.

While this is possible, at some point of time the need to bring money back to India might arise, so, under what head of income will one declare it? If the gains are substantial, won't the taxman come calling in these days of big data? (Or even if you regularly keep moving a good amount abroad every year).

Believers might still figure out ways to get around the system, but for most normal souls this is not worth the trouble. This is something that the bitcoin believers haven't gotten their heads around to (yes, yes, yes, have fun stay poor). Like one individual told me that he can simply bribe the taxman (I mean, yes, you can also do *hawala* and get your money in cash).

Another factor that needs to be kept in mind here is that the government in the next few years is going to be desperate for tax revenues. I guess I will leave this point here.

The bitcoin brokers in India are desperately trying to spin the usefulness of bitcoin in many interviews in the mainstream media. In fact, in one interview, Sumit Gupta, CEO & Co-Founder of CoinDCX, pointed out that there are 75 lakh bitcoin investors in India. A report in The Times of India puts the number at 1 crore. No source has been provided for these numbers.

The interesting thing is that Gupta feels that " *there is a lot of confusion in calling bitcoin as cryptocurrency and not calling it an asset* ." He wants bitcoin in India to be considered as an asset and be regulated. He doesn't want it to be considered as money.

If something like this where to happen, it changes quite a few things.

When an investor buys a company's stock, he is buying a share in the future earnings of the company. When he buys mutual funds, he is indirectly buying stocks or other financial securities issued by companies or even something like gold. When he buys gold, he buys gold.

When he buys derivatives, he is either hedging against price fluctuation or speculating on the price of a certain commodity. When he buys real estate he buys a home to live in or as a physical asset to profit from in the years to come. I mean one can go on and on here.

*(Charles Ponzi on whom the Ponzi scheme is named).*

What does one buy, when one buys bitcoin as an investment asset? Nothing. It would be fair to say that if you take out bitcoin's or for that matter any other cryptocurrency's ambition to emerge as a parallel form of money out of the equation, it simply becomes a Ponzi scheme. (Don't think Gupta realised this while making the point that he did). (You can read why I think bitcoin will never be money, here and here ).

A Ponzi scheme is a financial scheme, where a fraudulent promoter promises very high return in a very short period of time to investors. He has no business model to earn this money in order to deliver returns.

The money being brought in by the second set of investors is used to pay off the first set. Or they are encouraged to roll over. As the news of high return spreads, more and more investors get sucked into the scheme, with the greed of earning potentially very high returns driving their investment.

This continues until the money being brought in by the new set of investors is less than the money being redeemed to the older set. Then the scheme collapses. Of course, most promoters disappear with the money before reaching such a stage.

Bitcoin without monetary ambitions is exactly like that. Money being brought in by newer investors pushes the price up, given the limited supply and prices go up very quickly, allowing existing investors to benefit.

As long as money being brought in by fresh investors is higher than money being taken out by existing ones, bitcoin keeps going up. When the equation changes, just like in a Ponzi scheme, bitcoin price crashes.

It's basically the Ponzi scheme structure of bitcoin which explains its huge volatility on the price front. On February 21, the price of bitcoin was $57,434. Six days later on February 27, it was down by nearly a fifth to $46,345. Or take the period of six days between February 15 and February 21, when the price of bitcoin rose by a fifth (or 20%) to $57,434.

Of course, unlike normal Ponzi schemes, there is technology and thinking behind bitcoin and other cryptocurrencies. But that doesn't make them any less a Ponzi scheme.

Given this, it's time that the government steps into ban bitcoin and other cryptocurrencies. India has enough Ponzi schemes to deal with already. There is no point in adding more to the list.

26 February, 2021

# You Have Heard the Good News About GDP, Here's the Slightly Better News

The gross domestic product (GDP) figures for the period October to December 2020 were declared earlier in the day today . GDP is a measure of economic size of a country.

The good news is that the Indian economy is back on the growth path. It grew by 0.41% during the period. While the growth rate itself isn't great, it comes on the back of six months of a covid led economic contraction. And that's clearly good news.

But this bit most of you who follow the economy closely on the social media, must have already heard by now. So, let me give you some better news than this good news.

The Indian GDP is measured in two ways. One way is by adding up private consumption expenditure (the money you and I spend buying up things), government expenditure, investment and net exports (exports minus imports). If we leave government expenditure out of the GDP, what remains is the non-government GDP, which forms a bulk of the GDP. In the October to December period, it formed around 90.3% of the GDP.

For the GDP to grow on a sustainable basis, this part needs to grow. Given that the government is a small part of the Indian economy, it can only create so much growth by spending more and more money.

The non-government part of the GDP grew by 0.58% during October to December 2020, after contracting significantly during the first six months of the financial year.

What this tells us is that the private part of the economy recovered quite a bit during the period without the government trying to pump up economic growth. The government expenditure during the period was down by 1.13%. This is the slightly better news I was talking about.

The private consumption expenditure, which forms a major part of the non-government part of the GDP contracted by 2.37%, after having contracted much more, during the first six months of the financial year. This tells us that the consumers are gradually coming back to the market even though some apprehension still prevails. This apprehension is probably more towards going out and spending money in the services part of the economy.

The other important part of non-government GDP is investment. It grew by 2.56% during October to December, which is the best in a year's time. For jobs to be created, this growth needs to be sustained in the months to come.

The other way of looking at size of the economy is to add up the value added by the various sectors. Of this, the services sector, from hotels to real estate to banking to trade to broadcasting to transport to public administration, form nearly half of the economy. And if economy has to get back on track, it is these sectors that need to get back on track. The services sector grew by 0.98% during the period, though this was better than the contraction seen during the first six months of the year.

Agriculture was the standout sector and it grew by 3.92% during the period. In fact, October to December is the biggest period for agriculture during the year and the sector has done well during its biggest quarter. On the other hand, manufacturing grew by 1.65%.

What this tells us is that the economy is gradually coming back to where it was before covid. It is worth remembering here that even before covid the Indian economic growth was slowing down. All in all, the real challenge for the Indian economy will start in the second half of the 2021-22, once the base effects of the covid led economic contraction are over. As I have said in the past, the economic growth rate during the first half of 2021-22 will go through the roof, but that will be more because of base effect than anything else.

Nonetheless, even with this recovery during the second half of the financial year, the Indian economic growth is expected to contract by 8% during 2020-21. This figure has been revised upwards. The Indian GDP was earlier expected to contract by 7.7% during the year.

The main reason for this lies in the revision of the government expenditure expected during the year. As per the first advanced estimate of the GDP for 2020-21 published in early January, the government expenditure for 2020-21 was expected to be at Rs 17.48 lakh crore. In the second advanced estimate published today, it has been revised to Rs 15.87 lakh crore, a cut of 9.2%.

From the looks of it, the central government is trying to cut down on the targeted fiscal deficit of Rs 18.49 lakh crore for 2020-21. Fiscal deficit is the difference between what a government earns and what it spends.

25 February, 2021

# Modi's Rs 2.5 lakh cr Asset Sale Plan Needs a Transparent Approach

The Prime Minister Narendra Modi has set a target of monetising 100 government-owned assets across sectors. As he said: "We have a target of 100 assets from oil, gas, airport, power, which we plan to monetise. This has the potential for investment opportunities of Rs 2.5 lakh crore."

This is in continuation of the idea that the finance minister Nirmala Sitharaman had presented in her budget speech on February 1, 2021. As she had said :

> *"Idle assets will not contribute to Atmanirbhar Bharat. The non-core assets largely consist of surplus land with government Ministries/Departments and Public Sector Enterprises. Monetising of land can either be by way of direct sale or concession or by similar means."*

Hence, a lot of this idle assets are government owned land or will involve land in some form or other. This is a good and an innovative idea which some of the previous budgets lacked.

Many large Indian cities have a lot of government land lying idle while the cities on the whole are stretched for land. Hence, freeing up some of this land and earning some money in the process is a good idea.

Let's look at this greater detail pointwise.

**1)** If you are the kind who likes walking around India's big cities, you would definitely see a lot of government land lying unused bang in the middle of cities. Close to where I live in central Mumbai is the Bicycle Corporation of India, in one of the by lanes of Worli. In the one and half decades I have walked past the company, I haven't seen any economic activity happening. Peepul trees now grow from the walls.

This is land bang in the middle of Mumbai, some of the most expensive real estate in the world, lying unused. This is criminal to say the least. Another great example of unused real estate are all the MTNL offices, all across Mumbai and Delhi.

The Heavy Engineering Corporation (HEC) in the city of Ranchi where I was born and raised, has acres and acres of land lying unused, while the city itself hardly has any land going around. This is land that has been lying unused for decades and needs to be put to some use.

**2)** It's not just the big cities that have all this excess land lying unused. Even a place like Ooty, has acres and acres of land lying unused thanks to the Hindustan Photo Films Manufacturing Company Ltd., which is largely not functional. There are quite a few such public sector enterprises which are no longer relevant, all across the country.

Given this, one of the first things that the government needs to do is to make an inventory of all this land and put it up in the public domain on a website. It needs to do so with all the other assets that it plans to monetise as well.

Of course, this inventory is not going to be made overnight and will take time. But it is important that this is done in the most transparent way, given that corruption/crony capitalism and land/asset sales, almost go hand in hand.

This is even more important because the government considers this route as an important source of revenue in the years to come. As the finance minister said in the budget that over the years the government hopes to earn more money "by increased receipts from monetisation of assets, including Public Sector Enterprises and land". Hence, getting the process right is very important.

This becomes even more important given that there will be great opposition to the process from those who benefit from the status quo and even otherwise. The government selling its assets to raise money to do other things is not seen as a good thing. Hence, even a hint of corruption or any other controversy can threaten to derail the entire process, something the government cannot afford at this point of time.

**3)** In cases where the land was taken from state governments to start a public sector enterprise, it is important that the land be returned to the state government and let the state government decide what it wants to do with it. In the years to come, state governments will also be running short of money to meet their expenditure.

Also, this is the right thing to do. The state government can also use the land to attract more investment into their state. In some cities where there aren't enough public parks, some land can even go to develop such infrastructure. The aim shouldn't be to maximise the money earned all the time, but maximise the general well-being.

Again, this is something that will need some amount of thinking and the government's thinking on this should be clear and out in the public domain.

**4)** There is another factor that needs to be kept in mind here. Real estate prices in most big Indian cities have remained and continue to remain high. One of the major reasons for this lies in the fact that the land prices remain expensive across Indian cities. Hence, it is important that some of this land be sold to build affordable housing. Only if land prices come down, will home prices come down.

And by affordable housing I mean homes which can be sold profitably in the range of Rs 10-20 lakh per unit and not affordable housing as the way the RBI defines it, which isn't really affordable housing at all, but just a fancy moniker to help banks meet their priority lending targets.

Other than helping people buy affordable homes to live in, the real estate sector has the ability to create a large number of jobs very quickly. It also has the capability to have a multiplier effect across many other sectors. Building real estate requires cement, sand, steel, bricks, pipes, etc., and so on. Once real estate has been built in, moving into a home requires its own set of purchases. Buying homes also gives a fillip to the home loan business. And of course, people living in homes they own, enhances general well-being.

**5)** Finally, it is important that the money earned through this route be used for a specific purpose and not just for bringing down the fiscal deficit, which has ballooned to Rs 18.49 lakh crore or 9.5% of the gross domestic product (GDP) this year. Even in 2021-22, the fiscal deficit target has been set at a high Rs 15.07 lakh crore or 6.8% of the GDP. Fiscal deficit is the difference between what a government earns and what it spends and is expressed as a percentage of the GDP.

It is important that money coming from land sales be allocated towards specific infrastructure projects, preferably in the very state where land is being sold. This will make it easier to sell this idea to the state governments, whose cooperation is very necessary to make this idea a reality.

To conclude, the monetisation of excess government land in particular and other assets in general, is a good idea. Having said that, it needs to be executed in a proper process driven and transparent way.

This is an updated version of an article that first appeared on Firstpost on February 2, 2021.

24 February, 2021

# Why RBI is Doing Dhishum Dhishum With Bond Market

*I used to think if there was reincarnation, I wanted to come back as the President or the Pope or a .400 baseball hitter. But now I want to come back as the bond market. You can intimidate everybody.* – James Carville.

The Reserve Bank of India (RBI) is unhappy with the bond market these days. Well, it hasn't said so directly. A central bank rarely does. But a series of newsreports across the business media suggests so. (Oh yes, the RBI also leaks when it wants to).

The bond market wants the RBI to pay a higher yield on the government of India bonds it is currently issuing. The cost of the higher yield will have to be borne by the government of India, something that the RBI doesn't want.

And this is where we have a problem (don't worry I will explain this in simple English and not write like bond market reporters or experts tend to, for other bond market reporters and other bond market experts). Government bonds are financial securities which pay an interest and are issued by the government in order to borrow money.

Let's try and understand this issue pointwise.

**1)** The government's gross borrowings for 2020-21, the current financial year, had been budgeted at Rs 7.8 lakh crore. In May 2020, after the covid pandemic broke out and the tax collections crashed, the number was increased to Rs 12 lakh crore. The final borrowings are expected to be at Rs 12.8 lakh crore. In 2021-22, the gross borrowings of the government are expected to be at Rs 12.06 lakh crore.

Hence, over a period of two years, the government will end up borrowing close to Rs 25 lakh crore. It isn't surprising that the bond market wants a higher rate of return or yield as it likes to call it, from government bonds, given that the financial savings in the country will not expand at the same rate as government borrowing is expected to. Also, there is no guarantee that the government will stick to borrowing what it is saying it will borrow. That's a possibility the market is also discounting for.

**2)** Take a look at the following chart which plots the 10-year bond yield of the government of India. A 10-year bond is a bond which matures in ten years and the return on it on any given day is the per year return an investor will earn if he buys that bond on that day and holds on to it until maturity.


Source: www.investing.com

As can be seen from the above chart, the 10-year bond yield has largely seen a downward trend since January 2020, though since January 2021 it has gradually been rising. As of the time of writing this, it stood at 6.14%, having crossed 6.2% on February 22.

Media reports suggests that the RBI wants the yield to settle around 6%. The bond market clearly wants more. This explains why in the recent past bond auctions have failed with the bond market not buying bonds or the RBI refusing to sell them at yields the bond market wanted.

**3)** The question is why does the bond market now want a higher rate of return on bonds than it did in 2020. There are multiple reasons for it. Bank lending has *largely* collapsed during this financial year and has only improved since October. Between March 27, 2020 and January 29, 2021, the overall bank lending has grown by *just* Rs 3.34 lakh crore, with almost all of this lending carried out during the second half of the financial year.

This forms around 27% of the deposits of Rs 12.3 lakh crore that banks have managed to raise during the period. Clearly, the banks haven't been able to lend out a large part of their fresh deposits.

Hence, it has hardly been surprising that a bulk of the bank deposits have been invested in government bonds. During the period Rs 6.94 lakh crore or 56% of the deposits have been invested in government bonds. Along with banks, other financial institutions have had few lending/investment opportunities, leading to a lot of money chasing government bonds, which has led to lower returns on them.

Over and above this, the RBI has flooded the financial system with money by cutting the cash reserve ratio (CRR) and by also printing money and buying bonds (something it refers to as open market operations), thereby driving down returns further.

**4)** What has changed now? The budget expects India to grow by 14.4% in nominal terms (not adjusted for inflation) in 2021-22. Even in real terms (adjusted for inflation), India is expected to grow by at least 10%. This basically means that bank and other lending will pick up. At the same time, the government borrowing will continue to remain high at Rs 12.06 lakh crore. Hence, there will be more competition for savings in 2021-22 than has been the case during this financial year, given that savings are not going to rise suddenly. Hence, yields or returns on government bonds need to go up accordingly. QED.

**5)** There is another point that needs to be made here. Thanks to the RBI wanting to drive bond yields and interest rates down, there is excess liquidity in the financial system right now. Lending to the government is deemed to be the safest form of lending. If lending to the government becomes cheaper, interest rates on everything else also tends to go down.

As of February 23, the excess liquidity in the financial system stood at Rs 5.7 lakh crore. This is money which banks have parked with the RBI.

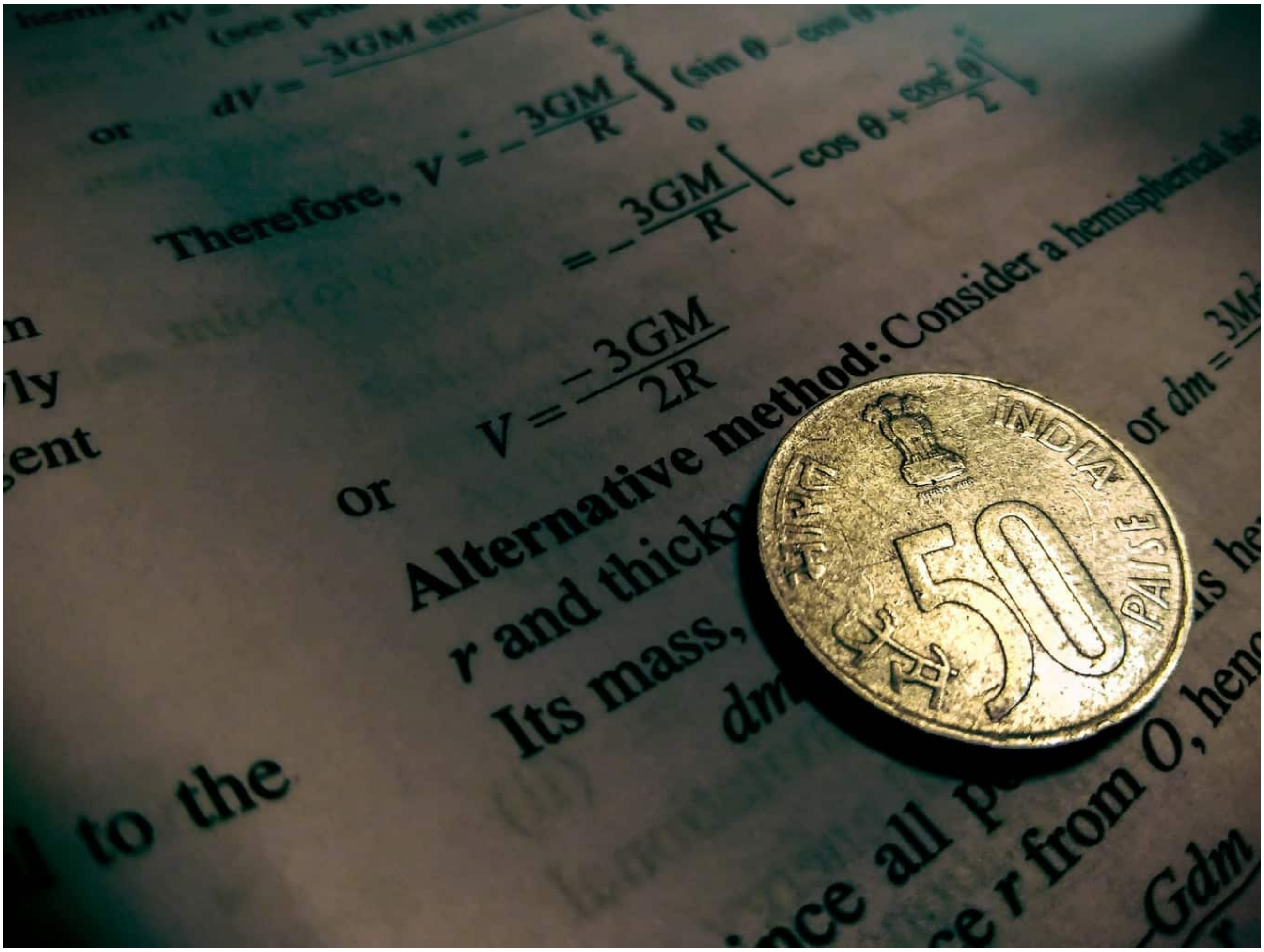
On February 5, the RBI governor, Shaktikanta Das, had said : "A two phase normalisation of the cash reserve ratio (CRR) – which I am going to announce – needs to be seen in this context."

The banks need to maintain a certain proportion of their deposits with the RBI. It currently stands at 3%. In April 2020, the RBI had cut the CRR by 100 basis points to 3%. One basis point is one hundredth of a percentage. With the banks having to maintain a lower proportion of their deposits with the RBI there was more liquidity in the financial system, which helped drive down yields and interest rates.

Now the RBI wants to increase the CRR in two phases. Assuming it wants to increase the CRR to 4%, this means that more than Rs 1.56 lakh crore (using data as of February 23) will be pulled out of the financial system by banks and be deposited with the RBI, in the months to come.

The bond market is discounting for this possibility as well, even with Das saying: "systemic liquidity would, however, continue to remain comfortable over the ensuing year." What this basically means is that the RBI will continue to carry out open market operations by buying bonds and pumping money into the financial system as and when it deems fit.

Having said that, the overall liquidity in the financial system will go down, simply because once the RBI withdraws more than Rs 1.56 lakh crore through raising the CRR, it isn't going to pump in the same amount of money back into the system, through open market operations, simply because then there would have been no point in increasing the CRR.




**6)** If your head is not spinning by now, dear reader, then you are clearly a bond market veteran. (Now isn't the stock market so much simpler). Basically, the RBI is trying to play two roles here. It is the government's debt manager and banker. At the same time, it also has the mandate of maintaining the rate of consumer price inflation between 2-6%. And at some level these objectives go against each other.

As the government's debt manager, the RBI needs to ensure that the government is able to borrow at lower rates. In order to do that the RBI now and then floods the system with more money and drives down rates.

The trouble with flooding the system with more money in an economy which is recovering from a huge economic shock, is higher inflation as there is the risk of more money chasing the same amount of goods and services. Of course, with the manufacturing sector having a low capacity utilisation, they can always start more machines and pump up more goods, and ensure that inflation doesn't shoot up. But the risk of inflation is there, given that money supply (M3) as of January 29, had gone up by 12.1%, year on year.

Over the years, there has been a lot of debate around whether the RBI should continue being the debt manager to the government or should that function be split up from the central bank and another institution should be created specifically for it, with the RBI just concentrating on managing inflation. I guess, in times like the current one, this suddenly starts to make sense.

**7)** Okay, there is more. The yield on the 10-year US treasury bond has been rising and as I write it has touched 1.33% from around 0.92% at the end of 2020. A major reason for this lies in the fact that the bond market is already factoring in the plan of the newly elected American president Joe Biden to spend more money in order to drive up economic growth.

Of course, with bond yields rising in the US, there is bound to be an impact everywhere else, given that the American government bond is deemed to be the safest financial security in the world. This has added to further pressure on the yields on the Indian government bonds.

**8)** After the finance minister presented the budget, the bond market realised that the government has huge borrowing plans even in 2021-22 and that even this financial year it would borrow Rs 80,000 crore more than the Rs 12 lakh crore it had said it would.

Accordingly, the 10-year bond yield moved up from 5.95% on January 29 to 6.13% on February 2, a day after the budget was presented. The RBI carried out open market operations worth Rs 50,169 crore between February 8 and February 12, on each of the days, to increase the liquidity in the financial system and push the yield below 6% to 5.99% on February 12.

But the yields have gone back up again and stand at 6.14% at the point of writing this. Interestingly, t he yields on state government bonds have almost touched 7.2%.

Clearly, the bond market has made up its mind as far as yields are concerned. The way out of this for RBI is to print more money and buy more government bonds and drive down yields. Of course, this needs to be done regularly and by following a certain routine.

That's the trouble with printing money. A major lesson in economics since 2008 has been that printing money by central banks leads to printing of more money in the time to come, given that the market gets addicted to the *easy money* .

Let's see how the RBI comes out of this predicament, given that it has promised an "accommodative stance of monetary policy as long as necessary – at least through the current financial year and into the next year".

**9)** We aren't done yet. Other than being the debt manager to the government and having to manage the consumer price inflation between 2-6%, the RBI also needs to keep a look out for the dollar rupee exchange rate.

During the course of this financial year, the foreign institutional investors have brought in $35.4 billion to invest in the stock market. When they bring money into India they need to sell their dollars and buy rupees. This increases the demand for the rupee and leads to the rupee appreciating against the dollar.

When the rupee is appreciating against the dollar, the RBI typically sells rupees and buys dollars, in order to ensure that there is enough supply of rupees going around. In the process, the RBI ends up building foreign exchange reserves and it also ends up pumping more rupees into the financial system, thereby increasing the money supply, and pushing up the risk of a higher inflation.

Over and above this, the open market operations of buying bonds and cutting the CRR, this is another way the RBI ends up pumping money into the financial system. All this goes against its other objective of maintaining inflation.

One dollar was worth Rs 74.9 sometime in mid-November 2020. It has been falling since then and as I write this, it stands at Rs 72.4. What this means is that in the last few months, the RBI has barely been intervening in the foreign exchange market.

This brings us back to the concept of trilemma in economics, which the RBI seems to have hit. Trilemma is a concept which was originally expounded by the Canadian economist Robert Mundell. Basically, a central bank cannot have free international movement of capital, a fixed exchange rate and an independent monetary policy, all at the same time. It can only choose two out of these three objectives. Monetary policy refers to the process of setting of interest rates in an economy, carried out by the central bank of the country.

This explains why the RBI is letting the rupee appreciate, in order to ensure free movement of capital (at least for foreign investors) and an independent monetary policy. Let's say the RBI kept intervening in the foreign exchange market in order to ensure that the rupee doesn't appreciate against the dollar. In this situation, it would have ended up pumping more rupees into the financial system and thereby risking higher inflation in the process.

A higher inflation would have forced the RBI to start raising interest rates in an environment where the economy is recovering from a huge shock and the government is looking to borrow a lot of money. This would have led to the RBI losing control over its monetary policy. Clearly, it didn't want that. (For everyone wanting to know about the trilemma in detail, you can read this piece , I wrote in September last year).

**10)** Finally, an appreciating rupee has multiple repercussions. People like me who make some amount of money in dollars, get hit in the process. (I would request my foreign supporters to keep this in mind while supporting me . Okay, that was a joke!)

Further, it makes imports cheaper, going against the entire narrative of *atmabnirbharta* being promoted right now. If imports become cheaper, the local products will find it even more difficult to compete. Of course, cheaper imports is good news for the consumers, given that the main aim of all economics is consumption at the end of the day.

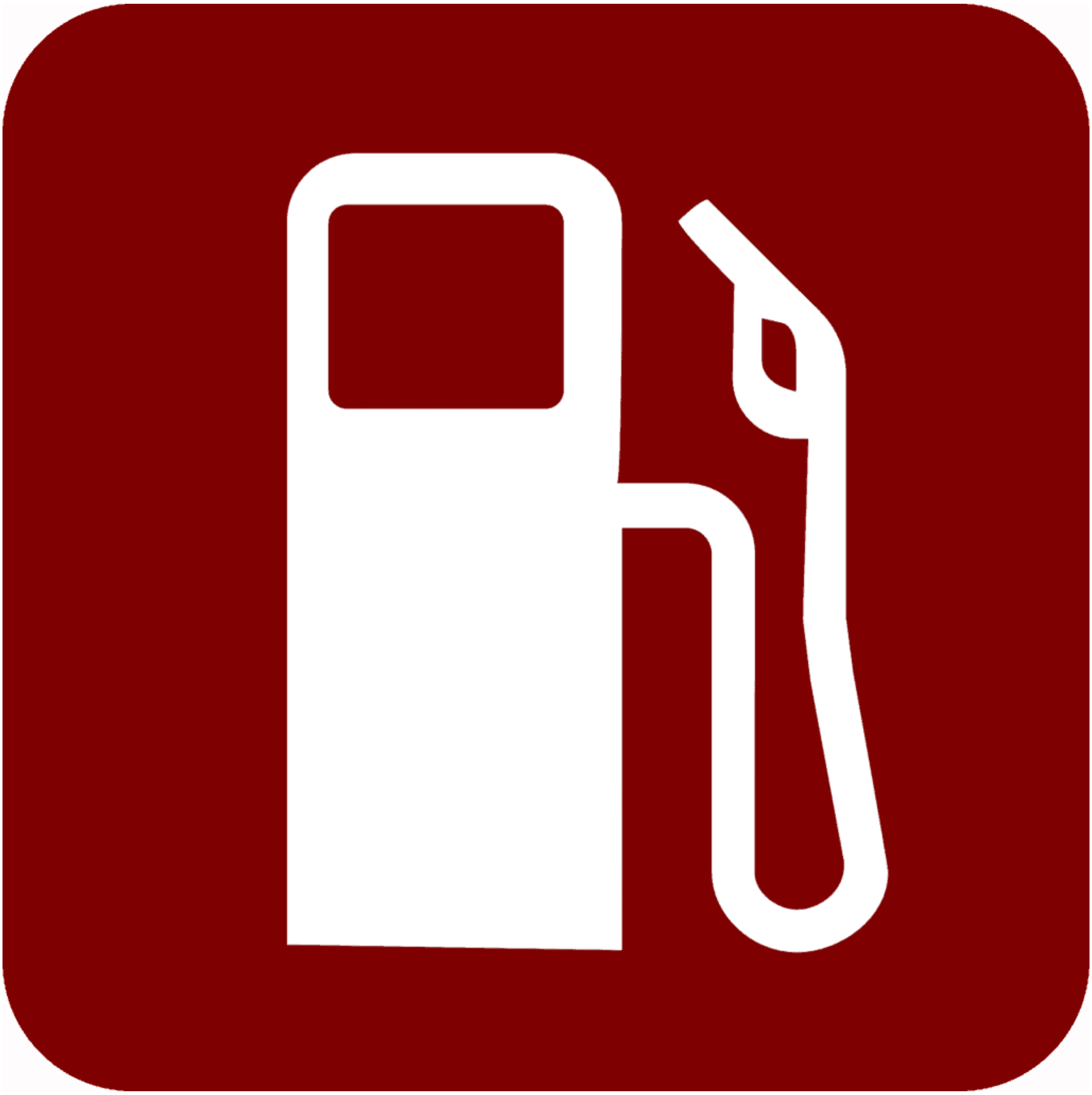
An appreciating rupee also hurts the exporters as they earn a lower amount in rupee terms, making it more difficult for them to compete globally. And all this goes against the idea of promoting Indian exports and exporters to become a valuable part of global value chains and boosting Indian exports.

To conclude, and I know I sound like a broken record (millennials and gen Xers please Google the term) here, there is no free lunch in economics. That's the long and short of it. All the liquidity created in the financial system to drive down yields on government bonds to help the government borrow at lower rates, is having other repercussions now. And there isn't much the RBI can do about it.

Of course, if the bond market keeps demanding higher yields, the RBI's *dhishum dhishum* with it will get even more intense in the days to come . If you are the kind who gets a high out of these things, well, continue watching this space then!

22 February, 2021

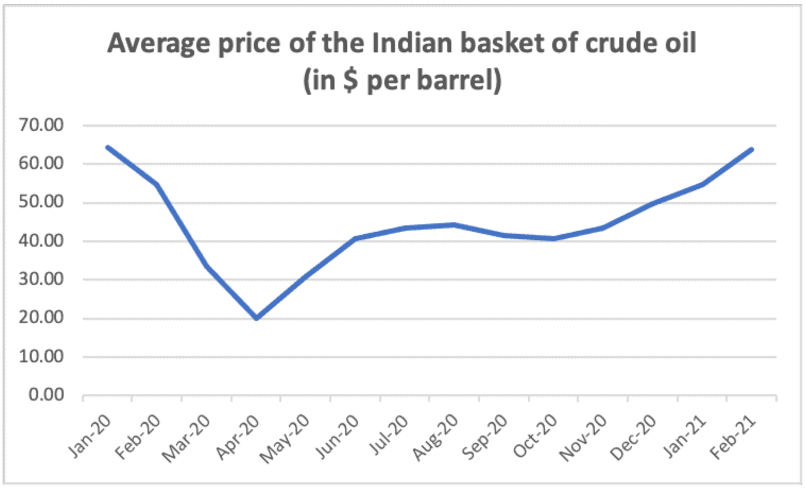
# Why the Price of Petrol is Racing Towards Rs 100 Per Litre



If there are two things that get people of this country *interested in economics* , they are the price of onion and the price of petrol racing towards Rs 100 per kg or litre, respectively. Currently, the price of petrol is racing towards Rs 100 per litre in large parts of the country. In fact, in some parts, it has already crossed that level.

So, what's happening here? Let's take a look at this pointwise.

**1)** Take a look at the following chart, which plots the average price of the Indian basket of crude oil since January 2020.



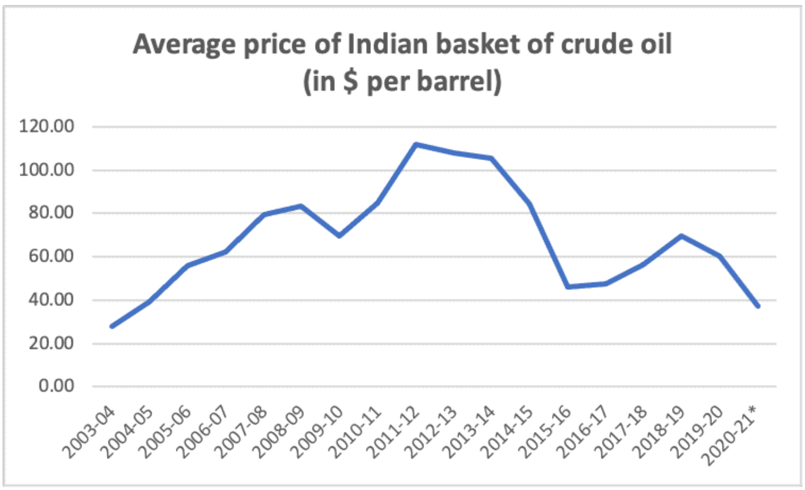

Source: Petroleum Planning and Analysis Cell.

*February price as of February 18, 2021.

What does the above chart tell us? It tells us that as the covid pandemic spread, the price of oil fell, falling to a low of $19.90 per barrel in April 2020. It has been rising since then. One simple reason for this lies in the fact that as the global economy recovers, its energy needs will go up accordingly and hence, the price of oil is going up as well.

The other reason has been the massive amount of money that Western central banks have printed through the beginning of 2020. Oil, as it had post 2008, has emerged as a hard asset of investment for many institutional and high-networth investors, leading to an increase in its price. As of February 18, the price of the Indian basket of crude oil stood at $63.65 per barrel, having risen by close to 220% during the current financial year.

**2)** Now let's look at the average price of the Indian basket of crude oil over the years.




Source: Petroleum Planning and Analysis Cell.

* Up to January 2021.

What does the above chart tell us? It tells us that the Narendra Modi government has been very lucky when it comes to the price of oil, with the oil price on the whole being much lower than it was between 2009 and 2014.

In May 2014, when Modi took over as the prime minister, the price of oil averaged at $106.85 per barrel. By

January 2016, it had fallen to $28.08 per barrel.

Even after that, the price of oil hasn't touched the high levels it did before 2014, in the post financial crisis years, which also happened to be the second term of the Manmohan Singh government.

A major reason for this lies in the discovery of shale oil in the United States. In fact, as Daniel Yergin writes in *The New Map – Energy, Climate and the Clash of Nations* : "In the autumn of 2018, though it was hardly noted at the time, something historic occurred: The United States overtook both Russia and Saudi Arabia to regain its rank as the world's largest oil producer, a position it had lost more than four decades earlier." This has been a major reason in the lower price of oil over a longer term.

The question that then crops up is why hasn't petrol price in India seen low levels? The answer lies in the fact that between 2014 and 2021, the taxes on petrol, in particular central government taxes have gone up dramatically.

In short, the central government has captured a bulk of the fall in oil prices. Now when the oil price has gone up over the course of this financial year, the high-price of petrol has started to pinch.

**3)** Take a look at the following table. It plots the price of petrol in Delhi as of February 16, 2021 and in March 2014.

**Price build up of petrol**

| (in rupees) | Petrol price build up as of Feb 16, 2021 | Petrol price build up as of March 2014 |
|---|---|---|
| Petrol price charged to dealers in Delhi | 32.10 | 47.13 |
| Excise duty (per litre) | 32.90 | 10.38 |
| Dealer commission | 3.68 | 2.00 |
| Total | 68.68 | 59.51 |
| Add state government's value added tax (@30%/20%) | 20.61 | 11.90 |
| Retail petrol price per litre | 89.29 | 71.41 |

Created with Datawrapper

Source: https://iocl.com/uploads/priceBuildup/PriceBuildup_petrol_Delhi_as_on_16_Feb-2021.pdf and https://www.ppac.gov.in/WriteReadData/Reports/201409231239065062686Snapshot_IOGD_MAR.pdf.

The above table makes for a very interesting reading. As of February 16, the price of petrol charged to dealers was Rs 32.1. Over and above this, the central government charged an excise duty of Rs 32.90 per litre on petrol. Add to this a dealer commission of Rs 3.68 per litre, and we are looking at a total of Rs 68.68 per litre.

On this the Delhi state government charged a value added tax of 30% or Rs 20.61 per litre. This leads to a retail price of petrol of Rs 89.29 per litre. Given that the state government charges a tax in percentage terms, the higher the price of petrol goes, the more tax the state government earns. The vice versa is also true.

Let's compare this to how things were in March 2014. The price of petrol charged to dealers was Rs 47.13 per litre, much lower than it is today. On this, the central government's tax amounted to Rs 10.38 per litre. The dealer commission was Rs 2 per litre.

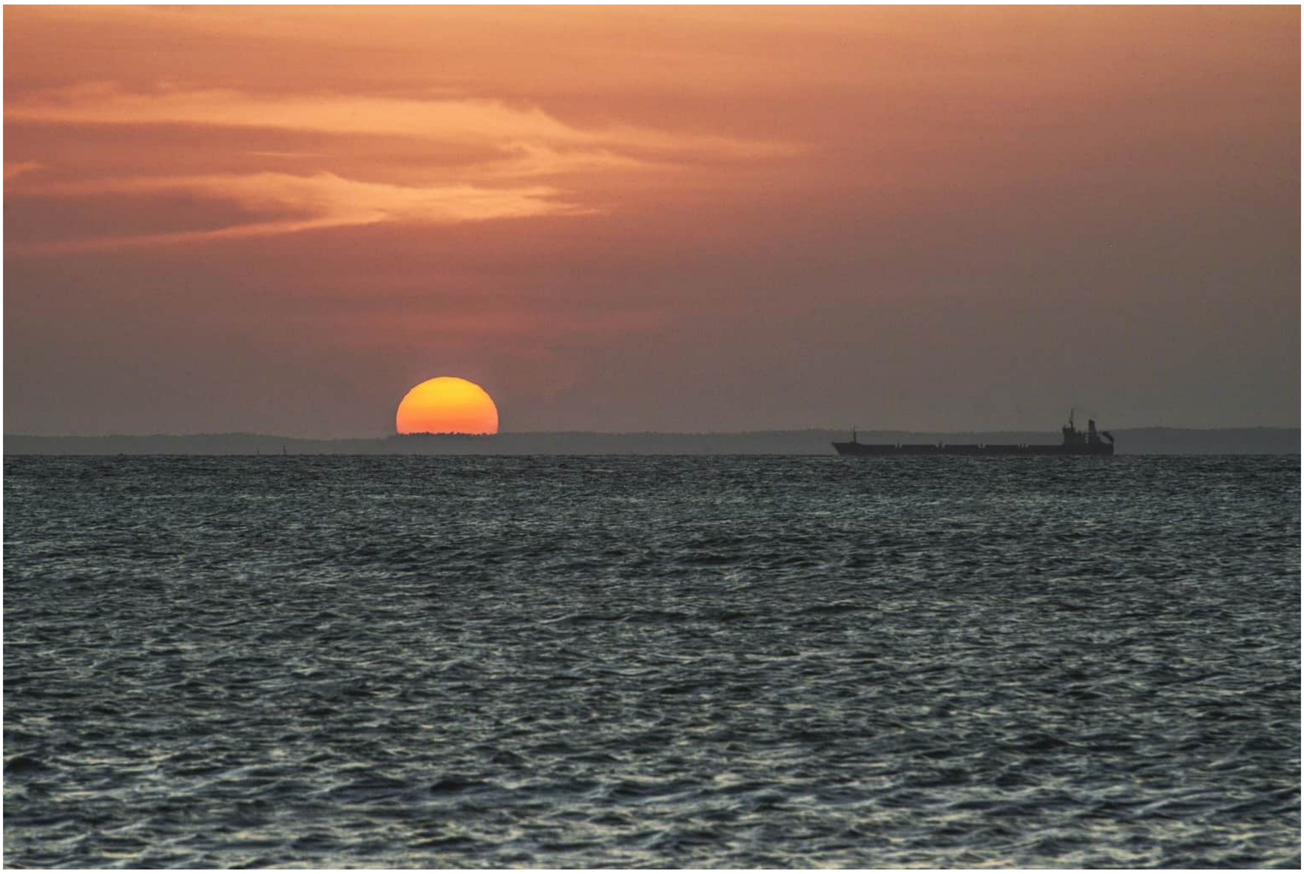
Adding all of this up, we got a total of Rs 59.51 per litre. On this, the Delhi state government charged a value added tax of 20%, which amounted to Rs 11.9 per litre and a retail selling price of petrol of Rs 71.41 per litre. Interestingly, the state government's tax was more than that of the central government at that point of time.

**4)** The above calculations explain almost everything. In March 2014, the price of petrol at the dealer level was higher than it is now, but the retail selling price was lower. Both the central government and the state government have raised taxes since then.

The total taxes as a percentage of dealer price now works out to 167% of the dealer price. In March 2014, they were at 47.3%. It is these high taxes which also explain why petrol prices in India are higher than in many other countries.

Of course, a bulk of this raise has come due to a rise in taxes charged by the central government. As mentioned earlier, the central government has captured a bulk of the fall in price of oil.

**5)** The calculation shown here will vary from state to state, depending on the value added tax or sales tax charged by the state government and the price at which petrol is sold to the dealers. States which charge a higher value added tax than Delhi will see the price of petrol reaching Rs 100 per litre faster than Delhi, if the price of oil continues to rise.



**6)** Of course, the governments can bring down the price of petrol by cutting taxes. In fact, four state governments have cut taxes providing some relief to oil consumers. But any substantial relief can be provided only by the central government. The trouble is that tax collections have fallen this year. Only the collection of excise duty has gone up by 54% to Rs 2.39 lakh crore, thanks to the higher excise duty charged on petrol and diesel.

The interesting thing is that the excise duty earned from the petroleum sector has jumped from Rs 99,068 crore in 2014-15 to Rs 2.23 lakh crore in 2019-20. The government has become addicted to easy revenue from taxing petrol and diesel. This year its earnings will be even higher than in 2019-20.

**7)** The central government also fears that if it cuts the excise duty on petrol and diesel, the state governments can step in and increase their value added tax, given that like the centre, they are also struggling to earn taxes this year.

Also, what needs to be kept in mind here is that the central government doesn't share a good bit of what it earns through the excise duty on petrol and diesel with the states. This is because a bulk of the excise duty is charged in the form of a cess, which the central government does not need to share with the states.

Let's take the overall excise duty of Rs 32.90 per litre of petrol currently. Of this, the basic excise duty is Rs 1.40 per litre and the special additional excise duty is at Rs 11 per litre. The road and infrastructure cess is at Rs 18 per litre (also referred to as additional excise duty) and the agriculture and infrastructure development cess is at Rs 2.50 litre. Clearly, the cess has a heavier weight in the overall excise duty.

**8)** One reason offered for the high price of petrol is low *atmanirbharta* or that as a country we have to import more and more oil than we did in the past. In 2011-12, the import dependency was 75.9%. This jumped to 77.6% in 2013-14 and has been rising since. In April to December 2020, this has jumped to 85%.

The explanation offered on this has been that oil companies haven't carried out enough exploration activities in the past. Let's take a look at the numbers of ONGC, the government's biggest oil production company (or upstream oil company, as it is technically referred to).

The total amount of money spent by the company on digging exploratory wells in 2019-20 stood at Rs 4,330.6 crore. This had stood at Rs 11,687.2 crore in 2013-14. Over the years, the amount of money spent by ONGC on exploration has come down dramatically. This explains to some extent why the crude oil production in India has fallen from 37.8 million tonnes in 2013-14 to 30.5 million tonnes in 2019-20, leading to a higher import dependency.

Of course, not all exploration leads to discovery of oil, nevertheless, at the same time unless you explore, how do you find oil.

The reason why ONGC's spending on exploration has fallen is primarily because the company has taken on a whole lot of debt over the past few years to finance the acquisition of HPCL and a majority stake in Gujarat State Petroleum Corporation's (GSPC) KG Basin gas block. The money that ONGC borrowed to finance the purchase of HPCL from the government was used by the government to finance the fiscal deficit. Fiscal deficit is the difference between what a company earns and what it spends.

The borrowing has led to the finance costs of the company going up from Rs 0.4 crore in 2013-14 to Rs 2,823.7 crore in 2019-20. The cash reserves of the company are down to Rs 968.2 crore as of March 2020 from Rs 10,798.9 crore as of March 2014.

All this explains why the price of petrol is racing towards Rs 100 per litre. At the cost of sounding very very very cliched, there is *no free lunch in economics* . Somebody's got to bear the cost.

It will be interesting to see if the central government continues to hold on to the high excise duty on petrol and diesel (whatever I have said for petrol applies for diesel as well, with a different set of numbers) leading to a high petrol and diesel price and lets these high rates feed into inflation in the process.

Keep watching this space.

17 February, 2021

# Why Farmers Still Don't Trust the Government

**Chintan Patel and Vivek Kaul**

In a recent column , the veteran editor Shekhar Gupta wrote that Indian politics is now clearly divided along economic lines, with the BJP + being 'unabashed backers of private sector' and others in the opposition being 'freshly dyed-in-red socialists'.

While definitive statements on politics of the day are rarely totally correct, they can always be placed in a certain context. Let's take the case of farm laws pushed very hard by the current union government and passed by the Parliament.

While there is no denying that economic reforms in agriculture are the order of the day, there is also no denying that the way these laws have been drafted and pushed through the Parliament, it makes the union government look like unabashed backers of the private sector, which in a democracy isn't possibly a *good thing* .

In the same column, Gupta quoted the former finance and home minister, P Chidambaram's view on the union budget, presented at the beginning of this month. Chidambaram, as Gupta quoted him, said: "It was a Budget… addressed to the one per cent of Indians who owned 73 per cent of national wealth."

Of course, Chidambaram's party, the Congress, which largely governed India up to 1996, with a few brief interludes in between, and then again from 2004 to 2014, has been responsible for a lot of this inequality.

If we were to take a leaf out of Gupta's book and make a definitive statement, what the Congress practiced for many years was bad socialism and what the BJP is currently practicing in case of the new farm laws, and as we shall see in this piece, is bad capitalism.

But before we get around to doing that we need to go back in history a little.

## The State of the Indian Farmer

Up until the mid 1960s, India was dependent on wheat imports, primarily from the United States. In order to set this right, the union government of the day promoted the green revolution. To encourage the farmers to grow a certain kind of wheat, the government provided price support, in the wheat-growing areas of Punjab and Haryana by buying wheat through the Food Corporation of India (FCI).

This essentially convinced the farmers to grow the specific kind of wheat that the government wanted it to, given that there was a ready buyer for it. This procurement of foodgrains initially started with the noble motive of helping the farmers who were taking part in the initial phase of the Green Revolution

Gradually, the FCI started procuring rice as well and thereby encouraged farmers to grow rice in the semi-arid region of Punjab as well as Haryana. In that sense, policies formulated to usher in the green revolution in the 1960s have long become outdated. They promote wrong cropping patterns that are neither environmentally optimal nor responsive to demands of the population. This has also led to depletion of ground water in large parts of Punjab and Haryana.

Thanks to the green revolution and the procurement infrastructure that developed because of it, India now overproduces foodgrains and does not produce enough of other food items, for which there is demand.

As of February 2021, the FCI had a total stock of rice and wheat amounting to 561.93 lakh tonnes. While the total stock that needs to be maintained as of January 1 every year, including the operational stock and the strategic reserve, amounts to 214.1 lakh tonnes.

Clearly, there is a problem of over production and over storage here. It also means that the government ends up over buying rice and wheat, which it doesn't really need and which then sits in the godowns of FCI and rots.

On the other hand, India isn't growing enough of something like pulses. While the per capita production has improved in the recent years, it is still not anywhere near where it used to be in the mid 1960s. In 2019-20, the per capita production of pulses stood at 16.9 kg, up from 13.6 kg in 2014-15, but still nowhere near a production of 25 kg per capita in 1964-65. [i]

The over production of rice and wheat doesn't just lead to underproduction of other agricultural crops, it creates other problems as well. (In order to get a good overview of the other problems, please click here to read a piece one of us wrote in September 2020 , when the farmer protests were just about starting).

We wouldn't be over-stretching if we say that there is a huge problem in the way agriculture is currently practiced in this country. And if Indians, and not just India, has to progress, the Indian agriculture system needs to be set right. The farming laws in their current state are not going to achieve that.

In 2020, farmers formed around 41.5% of India's workforce but contributed only around 15-16% of India's economic output. This basically means that farmer incomes are abysmal. The average household income of farmers was Rs 6,427 a month as per the Situation Assessment Survey of Agricultural Household 2013 – with farmers in some states making much lesser than the average. To give a sense of the state-wise skew on this figure, the income for Punjab was Rs 18,509, for Haryana it was Rs 14,434 (the top two) and that for Bihar it was just Rs 3,557. An average household in India has five members.

This data is on the slightly older side. One thing we can do is to adjust it for inflation between December 2013 and December 2020. The rural inflation as measured by the consumer price index between these two time periods stood at 4.4% per year. Assuming that the farmer incomes have grown at this rate per year, then the average household income of farmers stands at Rs 8,688 per month.

Of course, and as we have seen above, there are variations around the average income across the states, but even with that, the farming income is low. In this backdrop, it is clear that the status quo in Indian agriculture is untenable. Policy-makers face a stiff task of inducing changes in cropping decisions whilst improving farmer incomes.

There is also the promise of doubling farmer incomes by 2022, which was first made Prime Minister Narendra Modi at a rally in Bareilly on February 28, 2016 and reiterated by Arun Jaitley in the budget speech next day.

## The New Farm Laws

On September 27, 2020, President Ram Nath Kovind approved three Farm Bills (which were passed in the Lok Sabha on September 17 and in the Rajya Sabha on September 20). These laws are *seemingly* an attempt to achieve the twin objectives of raising farmer incomes and modifying cropping pattern. These laws are as follows:

1) The **Farmers' Produce Trade and Commerce (Promotion and Facilitation) Act 2020** (which the farmers refer to as the *APMC Bypass Act* ) creates a mechanism allowing the farmers to sell their farm produces outside the Agriculture Produce Market Committees (APMCs). Any license-holder trader can buy the produce from the farmers at mutually agreed prices.

2) The **Farmers (Empowerment and Protection) Agreement of Price Assurance and Farm Services Act 2020 (** referred to as Farmers Contract Act hereafter) seeks to create a legal framework for contract farming in India, wherein farmers can enter into a direct agreement with a buyer to sell the produce at predetermined prices through verbal or written contracts.

3) The **Essential Commodities (Amendment) Act 2020** is an amendment to the existing Essential Commodities Act, deregulating storage limits on items such as cereals, pulses, oilseeds, edible oils, onions and potatoes, except in extraordinary situations.

Farmer groups across the nation have opposed the new laws and brought their protest to the streets, and the ensuing stand-off with the union government has gone on for several months now. While protests against the farm laws have happened all across the country, the main sustained protest has happened on the borders of Delhi, leading many commentators to say that this is primarily a protest of large farmers of North India.

There is no denying that large farmers have the most to lose and are *maybe* driving this movement, nevertheless, at the same time it needs to be said that large protests typically tend to happen around the seat of power.

As veteran editor and economy watcher TN Ninan wrote in a recent column : " Much of the action in the French Revolution was centred on Paris." The same thing happened when the Bolsheviks led by Vladmir Lenin took over the strategic locations in the Russian capital of Petrograd (now known as Saint Petersburg). Hence, Delhi will remain symbolic in the same sense.

In this piece, we look at the different arguments put forth by those who are opposing these laws and try to figure out how much sense they make. We also look at the overall issue of agricultural reforms. Let's take a look at these pointwise.

1) A chief concern of farmer groups opposing these laws is that the new laws herald a change in policy which will lead to a roll-back on government procurement of foodgrains and minimum support prices (MSPs). The government declares MSPs for 23 crops every year, but it primarily buys rice and wheat directly from farmers at the MSP. In the recent past, it has also bought pulses and oilseeds to promote their production.

Apprehensions regarding the dismantling of the MSP regime explain the mass mobilization of farmers in Punjab, Haryana and western UP – areas with high government procurement of grains, due to historical reasons of the union government wanting to promote the green revolution in the country.

While the new legislation itself is silent on the MSP, the government has repeatedly given assurances that procurement and MSPs will continue. But these assurances in isolation haven't been enough to placate farmer fears. There are multiple reasons for the same.

As NITI Aayog's occasional paper titled *Raising Agricultural Productivity and Making Farming Remunerative for Farmers* published in December 2015, points out: "There is a need for reorientation of price policy if it is to serve the basic goal of remunerative prices for farmers. This goal cannot be achieved through procurement backed MSP since it is neither feasible nor desirable for the government to buy each commodity in each market in all region."

This paper essentially had the philosophical underpinnings on which the new farm laws are based.

Also, if the government purchases and the MSP are done away with, there will be further danger of free power, fertiliser subsidy etc., being done away with as well. This is something that farmers who benefit from these things, wouldn't want.

Secondly, if the idea is to promote private corporate trade in agriculture over a a period of time, then it is but natural for the government to gradually get out of the sector. That is how liberalisation of any sector has worked over the years. Hence, the government's assurance on MSP and procurement haven't carried much weight with the farmers.

On the flip side, the rice and wheat which the FCI buys directly from the farmers, it distributes through the public distribution system or ration shops as they are more popularly known, at a very low price to meet the needs of food security.

Given that the public distribution system is in place, it will be very difficult for the government to *totally* get out of the system of declaring MSPs and procuring rice and wheat. Also, the importance of this system has come into focus in the past one year, as the government distributed free rice and wheat through these shops across the country, to negate the negative economic impact of the spread of the covid-pandemic.

Hence, it is highly unlikely that the government will do away with MSPs and procurement, though the level of procurement might come down over the years, with the government only buying as much as it needs to fulfil the needs of food security and not more.

Net net, the system as it exists is likely to change in the years to come. Further, given the way the government pushed the farm laws through the Parliament, it has become difficult for the farmers to trust the government.

**2)** Other than the MSP issue, there are several other reasons which have farmer groups alarmed.

Central to a bulk of these concerns is the role of the Agricultural Produce Market Committees or APMCs. The new APMC-bypass law does not explicitly call for the closure of existing APMCs (or mandis as they are more popularly known as). However, it allows private-party transactions between buyers and sellers outside the mandis. Transactions that take place outside the APMCs are not subject to either state cess or state APMC laws.

This effectively creates two parallel marketplaces – one that is highly regulated, and one that is very lightly regulated, if at all. One that is controlled by the state governments and another that is controlled by the union government.

Farmers contend that such an arrangement is effectively a death-knell for the mandis, as non-mandi transactions have been heavily incentivized. They argue that a regulated marketplace within the mandi will be replaced by an unregulated marketplace outside the APMC framework. Transactions conducted outside the APMCs would be no longer regulated in the same way, implying that government officials cannot step in to address irregularities around weighing and measurement of produce and payment disputes.

Now, *sarkari* interference in a commercial transaction or setting, is mostly viewed as a bureaucratic hurdle by all parties involved. Yet interestingly the prospect of getting rid of this oversight has the farmers concerned implying that their fear of being exploited by buyers and traders in an unregulated setting, outweighs whatever shortcomings there might be in the existing system.

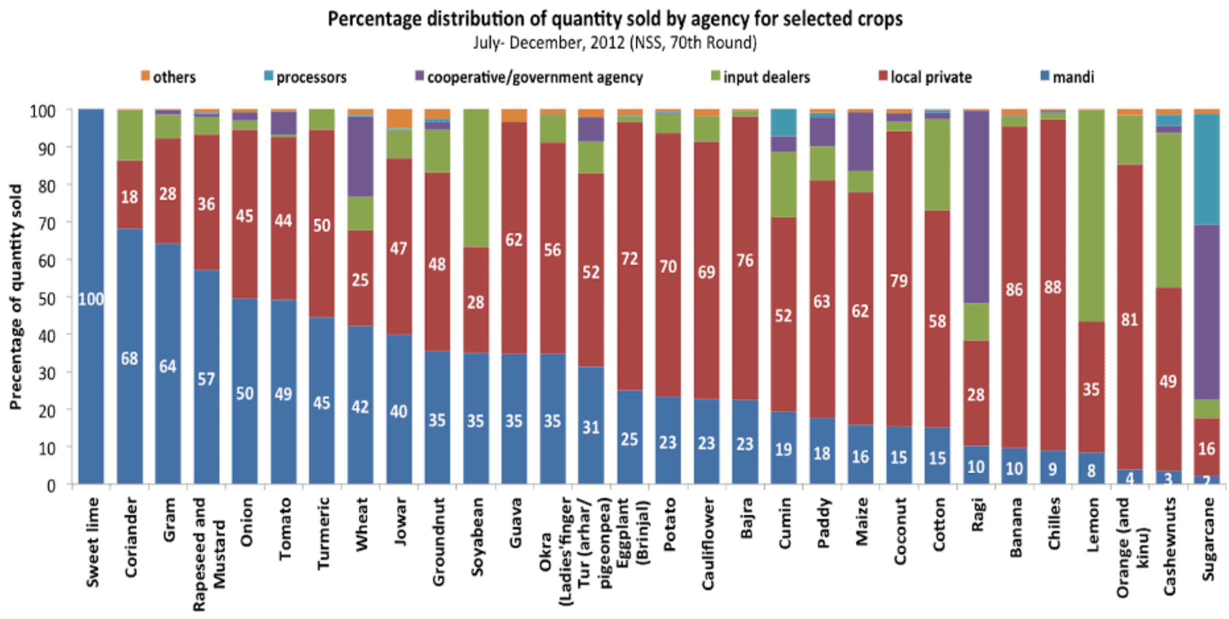
On the flip side, the outside competition should help in driving down the high mandi fees, which exist currently.

Experts who have come out in support of these laws have pointed out that the removal of the APMC cess, removal of barriers of entry for new purchasers and increased competition for crop procurement, which these new laws are likely to bring in, will help drive crop prices higher. So, why then are farmers so resistant to the new unregulated marketplace?

One patronizing line of reasoning, as has been the case whenever reforms are pushed through stealth, is that the farmers are too naive to understand what is really in their best interests, presumably due their ignorance of economics and benefits of free-markets.

The link between reduced regulations and increased prosperity is well established in other sectors in post-liberalized India. That said, discounting the lived experience and opinion of the stakeholders and purported beneficiaries of a given law is unwise.

It is important to note that a large portion of farm trade *already* occurs outside of APMCs. The chart below shows the proportion of sales across various channels for a list of agricultural commodities. It can be seen that non-APMC transactions feature prominently for most agricultural items.




Source: NSS Report 70th round.

Chart: https://www.theindiaforum.in/article/three-farm-bills.

Let's take the case of rice and wheat, the two foodgrains primarily bought by the government directly from the farmer. In case of rice (paddy) 63% of the total quantity was sold in local private markets. In case of wheat it was at 25%.

This happens for a host of reasons such as distance constraints, door-step sales to offset past debt, the difference in government procurement infrastructure across different parts of the country, etc.

The best metric of efficacy of any new policy will be its effect on farmer incomes, which are ultimately determined by prices farmers get for their produce. And this is where APMCs play an important role in the price discovery process. Prices for agricultural produce are decided in APMCs by open- auctions or closed-bid tenders.

Thus the APMCs serve as transmitters of pricing information across the market, as sales occurring outside the mandis are influenced by APMC prices as well. Once APMCs become obsolete, as is the fear, how will price discovery happen?  That is one concern raised by farm groups resisting the APMC-Bypass law.

In this sense, there needs to be some level playing field between APMCs and the new markets that are expected to spring up thanks to the new laws.

**3)** Another concern raised by critics is that the decline of APMCs will lead to fragmented markets and render farmers more vulnerable to exploitation by traders. The APMCs provide a platform for collective bargaining which is only possible with aggregated and coordinated sales. Once sales migrate to private, uncoordinated transactions there is a possibility of monopsonies emerging for each distributed geography pushing sale prices downward.

A monopsony is a market which has a single buyer, giving that sole player an undue advantage on dictating prices. As an example, if Maruti was the only car manufacturer in the country, it would enjoy a near monopsony over the automobile spare parts market. In such thin and fragmented markets, the balance of information and bargaining power will be heavily tilted against farmers, especially ones with small holdings.

While these fears are not unfounded, it should be pointed out that the existing system of price discovery and middlemen has been prone to manipulation by traders and commission agents, much to the detriment of farmers. As Sudha Narayan, a noted agricultural economist points out , even with open auctions, middlemen and traders often collude against farmers to depress sale prices.

Also, it needs to be said here that most of India's farmers are too small to be dealing with any marketing system on their own. The point being that even in the new markets that are likely to emerge middlemen might continue to be the order of the day.

It is being assumed that buyers who currently buy from big commission agents, will start buying directly from farmers and let go of the middleman. There is a reason why these buyers buy from agents. It is convenient for them to do so. Do they want to take on the headache of building a new system right from scratch? *Is it worth their time and money?*

These are questions for which answers will become clearer in the days to come. But prima facie given the abysmal ease of doing business in most states, we see no reason why the buyers won't continue buying from the agents, instead of having to deal with many farmers. This is a point that needs to be kept in mind as well.

For such small farmers to be able to benefit and get a better price for their produce without selling to a middleman, all kinds of other infrastructure is needed. These include everything from more cold storages to improved roads connecting villages to the newer markets that come up, power supply which can be relied upon (so that a cold storage can function like one) and traders who compete to get their produce.

It is worth remembering that *arthiyas* (commission agents) who buy produce from farmers at APMCs, are locally influential people. Hence, assuming that parallel systems of buying and selling in the form of new trade markets, will come up automatically, is *rather* lame.

It is worth remembering that many *arthiyas* are themselves big farmers and can ensure that the system continues to work as it is. They might just move out of APMCs to avoid paying levies (which are very high especially in states of Punjab and Haryana at 8.5% and 6.5%, respectively). Everything else might continue to be the same. This depends on whether creation of new infrastructure is worth not paying the levy.

**4)** The displacement of trade into the unregulated sphere has another downside. It invisiblizes data. When agriculture sales and storage are not recorded centrally, key data points get lost. Evidence-based policy making requires robust data. Without the availability of data on sale prices, volumes and storage, policy makers could be rendered "blind", adversely affecting decisions regarding agriculture, food security, and food distribution.

One solution to this problem would be to mandate the recording of all trade outside APMCs be recorded in a central/state registry, especially if the new regulations lead to the creation of new markets with decent infrastructure (as opposed to fragmented, distributed transactions).

**5)** Other than profitability, these laws have also been opposed on the grounds of being unduly favourable to corporates. This, as we said at the very beginning, makes the government, look like an unabashed backer of the corporate system.

Section 15 of the Farmers' Produce Act says "no civil court shall have jurisdiction to entertain any suit or proceedings in respect of any matter, the cognisance of which can be taken and disposed of by any authority empowered by or under this Act or the rules made thereunder."

Instead, the adjudicating powers are given to Sub-Divisional Magistrates (SDMs) and Additional District Magistrates (ADMs) – both being bureaucrats. This has stoked fears of subversion of justice against the farmer. If there is a small farmer on one side of the dispute and a large or even a medium sized corporate on the other side, whose side is the bureaucrat likely to take? One doesn't need a degree in rocket science or an advance qualification in computer chip design, to answer this question.

This provision in the new farm laws, which doesn't allow farmers to take a dispute to a Civil Court, also seems to be in line with the narrative of too much democracy inhibiting economic reforms, that has been promoted in the recent past.

**So what is the net learning from all this?**

The attitude towards corporates highlights the us-vs-them mentality of farmer leaders and activists. If something is good for big business, it *must* be bad for them. Their argument is that the "freedoms" offered by the new laws vis-a-vis crop sales or storage *already existed* for the farmers. The changes introduced by the new farm laws are to essentially unshackle the corporates.

This extreme suspicion of corporates and their profit-making motives is unfortunate and can be attributed to both the legacy of socialist thought in India, the politicians often bad-mouthing businessmen, the less than exemplary behaviour of corporates themselves and instances of exploitative practices by corporates in the past.

A blanket fear of corporate involvement is arguably short-sighted, even if understandable due to past practices. Having a robust supply chain of climate-controlled warehouses and transportation is critical to allowing farmers to tap into larger national and international markets.

One practical way to do this at a substantial scale is to attract investment by large corporates. Corporatization en-masse doesn't have to mean exploitation of farmers. On the contrary, it can help realize higher incomes, given the correct safeguards and regulatory oversight, which has gone missing in the new laws.

This needs to be communicated as well as demonstrated with a few success stories if such materialize, where deregulation and entry of corporates leads to increased farmer incomes. Once farmers have seen concrete benefits maybe the psychology of distrust against corporate players can be reversed.

As Vijay Kelkar and Ajay Shah write in , In Service of the Republic : " The safe strategy in public policy is to incrementally evolve—making small moves, obtaining feedback from the empirical evidence, and refining policy work in response to evidence." Of course, moving incrementally goes against the very idea of a government which believes in making big moves and building a huge narrative around it.

Trust is perhaps the core issue that fuels farmer opposition. There seems to be a complete breakdown of trust in the current government from the farmers' end. The seeds of discontent were first sown by repeated inconsistencies between election manifestos and implemented policies.

Such tendencies are not unique to the current ruling party, but that hardly absolves them of some significant reversals on election promises. Issues that farmers find particularly grating are the inconsistencies in the Modi government's stance towards implementing the Swaminathan commission recommendations and their reversal on the promise to open 22,000 agriculture mandis for improved market access.

Also, what does not help is the way these laws were pushed through the Parliament, without any discussion being initiated with the farmers. The government got talking with them only after the protests erupted. In this environment, it is hardly surprising that there is low trust.

The government did itself no favours by the manner in which it introduced the new laws. Even if the intent is to benefit farmers by bringing in the new laws, the means employed by the government do not inspire confidence. Constitutional norms of deliberation and debate in the Parliament were circumvented to make sudden, sweeping changes on a state subject, reneging on our federal ethos.

Moreover, the laws were drafted unilaterally, without seeking inputs from farmers – the purported beneficiaries. Circumventing these good-faith practices has furthered suspicions held by detractors that the laws are indeed meant to further corporate interests only. What hasn't helped is the fact that farmers cannot challenge disputes arising under these news laws, in Civil Courts.

As the American experience of the late 19th century and early 20th century shows, unregulated capitalism only leads to robber barons and huge inequality in the society, which India has enough of already. Hence, bad socialism has now been replaced by bad capitalism.

Farmer protests continue to expose the deep fault lines in our agrarian economy. The response to these laws offer some valuable lessons to politicians and policymakers. For one, it is impossible to predict with certainty the effect of these laws on agriculture prices. The arguments put forth by farmers merit meaningful engagement.

Dismissing their concerns as misguided or malicious smacks of hubris. In a democracy, good leadership and policymaking is as much about means as ends. Transparency, debate and discussions are essential before draft bills become laws. It is essential to engage key stakeholders and socialize any big-bang changes to avoid surprises and minimize disruptions. One can only hope that the political class has the wisdom and grace to recognize their mistakes and learn from them.

But all this involves hard work, which is a tad too much for a government primarily engaged in building narratives and following them up purposefully. Also, by trying to push agricultural reforms through the stealth route and not engaging with the status quo, the government has done the cause of economic reforms a great harm. In the time to come, it will become even more difficult for it to push through any new economic reform, unless it sits and talks this one out with the farmers.

For starters it should offer to do away with some of the most controversial clauses in the new laws which favour the corporates at the cost of the farmers. That can at least be a small start.

[i] https://niti.gov.in/sites/default/files/2019-07/RAP3.pdf and author calculations on data from http://agricoop.nic.in/sites/default/files/FirstEstimate2020-21.pdf. Population of India in 2019 assumed to be 137 crore, using World Bank data.

14 February, 2021

# How Trustworthy are the Bad Loans Numbers of Banks?


The Reserve Bank of India (RBI) in the Financial Stability Report (FSR) released in January had said that by September, the bad loans of banks, under a baseline scenario, could shoot up to 13.5% of their total loans. In September 2020, the bad loans rate of banks had stood at 7.5%. Bad loans are largely loans, which haven't been repaid for a period of 90 days or more.

If the economic scenario were to worsen into a severe stress scenario, the bad loans could shoot up to 14.8% of the loans. For public sector banks, the rate could go up to 16.2% under a baseline scenario and 17.8% in a severe stress one.

What this meant was that the RBI expected the overall bad loans of banks to shoot up massively in the post-covid world, even more or less doubling from 7.5% to 14.8%, under a severe stress scenario.

A past reading of the RBI forecasts suggests that in an environment where bad loans are going up, they typically end up at levels which are higher than the severe stress level predicted by the RBI.

Given all this, there should be enough reason for worry on the banking front. But as things are turning out the dire predictions of the RBI are still not visible in the numbers. The quarterly results of a bunch of banks for the period October to December 2020 have been declared and it must be said that the banks look to be doing decently well.

In a research note, CARE Ratings points out that the bad loans rate of 30 banks which form the bulk of the Indian banking system (including the 12 public sector banks, IDBI Bank and the big private banks), stood at 7.01% as of December 2020. The rate had stood at 8.72% as of December 2019 and 7.72% as of September 2020.

In fact, when it comes to public sector banks, the bad loans rate has improved from 11.22% as of December 2019 to 9.01% as of December 2020 (This calculation includes IDBI Bank as well, which is now majorly owned by the Life Insurance Corporation of India and not the union government, and hence is categorised as a private bank).

When it comes to private banks ( a sample of 17 banks), the bad loans rate has improved from 4.87% as of December 2019 to 3.49% as of December 2020.

On the whole, these thirty banks had bad loans amounting to Rs 7.38 lakh crore on loans of Rs 105.37 lakh crore, leading to a bad loans rate of a little over 7%. Do remember, the RBI's baseline forecast for September 2021 is 13.5%. Hence, things should have been getting worse on this front, but they seem to be getting better.

What's happening here? The Supreme Court in an interim order dated September 3, 2020, had directed the banks that loan accounts which hadn't been declared as a bad loan as of August 31, shall not be declared as one, until further orders.

This has essentially led to banks not declaring bad loans as bad loans. Nevertheless, the banks are declaring what they are calling *proforma slippages* or loans which would have been declared as bad loans but for the Supreme Court's interim order.

A look at the results of banks tells us that even these slippages aren't big. The proforma slippages of the State Bank of India between April and December 2020, stood at Rs 16,461 crore, which is small change, given that the bank's total advances stand at Rs 24.6 lakh crore. When it comes to the Punjab National Bank, the total proforma slippages were at Rs 12,919 crore between April to December 2020.

Similarly, when we look at other banks, the proforma slippages are present but they are not a big number. An estimate made by the *Mint* newspaper suggests that India's ten biggest private banks have proforma slippages amounting to around Rs 42,000 crore.

The 30 banks in the CARE Ratings note had total bad loans of Rs 7.38 lakh crore or a rate of 7.01 %. If this has to reach anywhere near, 13.5-14.8% as forecast by the RBI, the overall bad loans need to nearly double or touch around Rs 14 lakh crore.

The initial data doesn't bear this out. As the RBI said in the FSR, "[With] the standstill on asset classification… the data on fresh loan impairments reported by banks may not be reflective of the true underlying state of banks' portfolios."

Hence, the situation will only get clearer once the Supreme Court decision comes in and the banks need to mark bad loans as bad loans. While banks are declaring proforma slippages, it could very well be that the Supreme Court interim order along with restructuring schemes announced by the RBI and the fact the Insolvency and the Bankruptcy Code remains suspended, have led to a situation where they are under-declaring these numbers.

This is not the first time something like this will happen. Around a decade back in 2011, Indian banks had started accumulating bad loans on the lending binge carried out by them between 2004 and 2010, but they didn't declare these bad loans as bad loans immediately.

Only after a RBI crackdown and an asset quality review in mid 2015, did the banks start declaring bad loans as bad loans. There is no reason to suggest that banks are behaving differently this time around.

It is important that the same mistake isn't made all over again. Hence, the RBI should carry out an asset quality review of banks(and non-banking finance companies) and force them to come clean on their bad loans.

A problem can only be solved once it has been identified as one.

The article originally appeared in the Deccan Herald on February 14, 2021.

11 February, 2021

# In a Country of 10 crore Urban Households, Builders Sold 2.62 Lakh Homes Last Year

I recently wrote a column in the Mint newspaper titled India and China: A tale of ghost towns in two gigantic countries . This piece is an extension of a small part in that column. Ideally, you should read the column before reading this piece, nevertheless, this piece stands on its own as well.

The real estate rating and research firm Liases Foras recently put out some interesting data in a report titled, *Residential Real Estate Market Report* . Let's look at this pointwise.

**1)** The home sales in the top 60 cities in India in 2020 stood at 2.62 lakh units. This was down 31% from 2019, when it had stood at 3.77 lakh units.

**2)** The sales in tier I cities (Ahmedabad, Bengaluru, Chennai, Hyderabad, Kolkata, Mumbai Metropolitan Area, National Capital Region, Pune) stood at 1.85 lakh units in 2020, down 32% from sales in 2019 when 2.75 lakh units had been sold.

**3)** The sales in tier II cities in 2020 stood at 76,603 units down 25% from 2019 when 1.03 lakh units had been sold.

**4)** The overall unsold housing inventory was down 6% to 12.52 lakh units in 2020, against 13.32 lakh units in 2019. The value of homes sold in 2020 stood at Rs 1.73 lakh crore, whereas the value of the inventory outstanding is at around Rs 8.65 lakh crore. At this rate, it will take five years to sell the current inventory (Rs 8.65 lakh crore divided by Rs 1.73 lakh crore).

Of course, this does assume that no new construction will happen over the next five years, which is a wrong assumption to begin with. Hence, the current inventory will take longer than five years to sell, unless sales pick up at a dramatic rate, which as far as I see it is unlikely to happen, given the state of the economy and the general purchasing power of Indians, which the real estate industry never seems to take into account.

Let's use this data and make some assumptions to explain *all over again* why the Indian real estate industry is in a mess and what can be possibly done to revive it.

**1)** In 2020, a total of 2,62,055 homes were sold across the top 60 cities in India with the total value of these sales being Rs 1,72,770 crore. This means that the average price of a home sold stood at Rs 65.92 lakh (Rs 1,72,770 crore of sales divided by 2,62,055 homes sold). In comparison to 2019, the average home price has barely fallen. In 2019, the average home price was Rs 65.96 lakh (Rs 2,48,861 crore of sales divided by 3,77,295 homes sold).

Let me not analyze this number further and make a few adjustments first.

**2)** Let's consider the tier I and tier II cities separately. The average home price in tier I cities in 2020 was at Rs 74.37 lakh (Rs 1,37,921 crore of sales divided by 1,85,452 homes sold). The average home price in tier I cities in 2019 was Rs 73.57 lakh (Rs 2,02,089 crore of sales divided by 2,74,680 homes sold). In tier I cities, despite home sales crashing by 32% in terms of number of units sold, the average home price has gone up marginally. There can be various local reasons for it which the overall average won't reveal, but on the whole it is safe to say that real estate sales don't seem to follow the basic law of demand in India. They never have and which is why the sector has been in a mess for more than half a decade now.

**3)** Within tier I cities, let's make one more adjustment by first checking what was the average home price in Mumbai Metropolitan Region (MMR), which tends to be higher than other parts of the country, simply because prices in Mumbai city tend to be very high. The average home price in MMR in 2020 was Rs 94.98 lakh (Rs 46,043 crore of sales divided by 48,479 homes sold). The average home price in 2019 had stood at Rs 99.11 lakh (Rs 67,938 crore of sales divided by 68,543 homes sold). Hence, the price in MMR has come down by 4.2% on an average between 2019 and 2020.

**4)** Now let's calculate the average price of a home in non MMR tier I cities. The average home price in a non MMR tier I city in 2020 stood at Rs 67.07 lakh (Rs 91,878 crore of sales divided by 1,36,973 homes sold). The average home price in a non MMR tier I city in 2019 had stood at Rs 65.08 lakh (Rs 1,34,151 crore of sales divided by 2,06,137 homes sold). Hence, the average home price in non MMR tier I city in 2020 has gone up by a little over 3%.

**5)** Now finally let's look at the average home price in a tier II city. The average home price in a tier II city in 2020 stood at Rs 45.49 lakh (Rs 34,849 crore of sales divided by 76,603 homes sold). The average price in 2019 had stood at Rs 45.58 lakh (Rs 46,772 crore of sales divided by 1,02,615 homes sold). Given this, the average home price in tier II cities has barely moved between 2019 and 2020.

What does all this data tell us?

**1)** At the risk of sounding as *cliched* as I can sound and have been sounding for years, the price of real estate in India is too high. Of course, we are looking at average prices here, but do take into account the fact that even in tier II cities the average home price is close to Rs 50 lakh.

In a tier I city without Mumbai, the average home price is close to Rs 67 lakh. Of course, there are tier I cities, like Pune and Ahmedabad, where the average price is closer to Rs 50 lakh. But even that is very high when one takes into account the fact that the per capita gross national disposable income in 2020-21 is expected to be around Rs 1.46 lakh.

Thus, the per capita household disposable income amounts to Rs 7.3 lakh (given that there are five people in an average Indian household). What needs to be kept in mind here is that this is the mean income of a household or the average income of an Indian household and not the median income or the income of an average Indian household. Hence, the income of the an average Indian household must be much lower than Rs 7.3 lakh per year.

**2)** Clearly, the real estate builders are building homes only for a certain section of the population, *the very rich* . And that has limited their market. In 2001, the number of urban households had stood at 5.58 crore. In 2011, this had jumped by 41.3% to 7.89 crore. Looking at this data, it is safe to say that by 2021, the number of urban households would have crossed 10 crore. Let's assume it is at 10 crore households, which I think is a reasonable assumption to make, given that the number of actual households should be much greater looking at the past trend and increasing urbanisation.

**3)** A bulk of these 10 crore households would be living in the top 60 cities of urban India. In these cities, in 2020, a total of 2.62 lakh new homes were sold by builders. In 2019, the number was at 3.77 lakh homes. Let's further assume that Liases Foras *probably* does not capture all the new homes being sold by builders across these 60 cities. Even if the homes sold were double of this number, they are barely a very small fraction of less than 1% of the total number of households in urban India. And this is true not just about 2020, it is equally valid for 2019, a non-covid year.

Of course, not all homes sold are new homes. People who have bought homes as an investment in the past and are now selling them, also need to be considered. There is no data available for this, but even if there was, the prices at which these homes were sold couldn't have been significantly different from the new homes being sold by builders, hence, limiting their affordability.

**4)** As I had said in my Mint piece earlier this week, India needs real affordable housing, homes which can be built and sold profitably in the range of Rs 5-20 lakh in Indian cities. Of course, these homes will be smaller in size, but they will be definitely much better and more humane than living in slums. And imagine if something like this takes off, what it could do to economic activity in a post covid world. Building of real estate leads to a lot of economic activity. Every apartment requires, cement, bricks, sand, steel, pipes etc. It also requires people to take on home loans.

The real estate sector has forward and backward linkages with 250 ancillary industries. This basically means that when the real estate sector does well, many other sectors, right from steel and cement to furnishings, paints, etc., do well. The multiplier effect is huge.

Also, real estate is one sector which can create a lot of semi-skilled and unskilled jobs, very quickly, thus help people move away from agriculture, which tends to employ more people than is economically feasible.

**5)** Of course, this is easier said than done. First, it needs the real estate industry to consider the idea of doing business profitably at a much lower price, which it currently doesn't seem to have got its head around to. Over the past few years, the real estate industry has maintained that it is difficult to cut prices given that input costs have gone up over the years.

It recently blamed the steel and the cement sector for driving up real estate prices. The cement industry has responded by saying: "only Rs 150/sq. ft of built up area constitutes cement costs. The amount being so low … is this not hoodwinking gullible consumers?"

I am no civil engineer and have absolutely no idea about what it costs to build a building, an apartment and so on. But what I do understand is that if real affordable housing has to become the order of the day, home prices need to come down and come down dramatically.

**6)** One thing holding back affordable housing is the cost of land in and around big cities. At the heart of this is the issue of Change in Land Usage (CLU). Agricultural land beyond a certain size cannot be owned, as per the land ceiling regulations. This limit varies from state to state. What this does is that it limits the amount of land available in cities unless the state government intervenes. And the moment that happens, the cost of the land starts to go up.

**7)** The central government and the state governments own a massive amount of land in Indian cities, which is lying unused. Over the years, some of it can be made available for real affordable housing. Of course, wherever there is land and there are politicians, there is scope for corruption (I really have no answer for this, honestly).

**8)** In a recent research report, IIFL securities looked at the cost of redevelopment projects in Mumbai. The figure that caught my eye is that the construction cost is 30.8% of the total cost. So, whatever the real estate industry might say, the construction costs forming less than a third of the overall cost, are really not the problem. I guess in non-redevelopment projects the construction cost as a proportion might be more, but even with that the problem is somewhere else.

It is the remaining charges that need to be brought down. Interestingly, charges related to the government in different ways (everything from floor space index charges to staircase premium to taxes to liaison cost) made up for around 40% of the overall cost. Clearly, the government is the problem here. The dependence on revenue from real estate for state governments needs to come down.

**9)** I am not an expert on this, but I do feel that this is an idea that needs to be made to work and there are experts out there who can look at it in a more detailed and feasible way.

To conclude, the problems holding back Indian real estate are huge and it will be very tough to sort them out. But as the corporates like to say *in adversity there is opportunity* . And *real* affordable housing is a huge opportunity, only if someone can figure out how to run a profitable business at lower costs. As the late Professor CK Prahalad would have said there is a fortune to be made at the *bottom of the pyramid* .

9 February, 2021

# More Than Half of Govt Taxes Will Go Towards Paying Interest on Past Loans

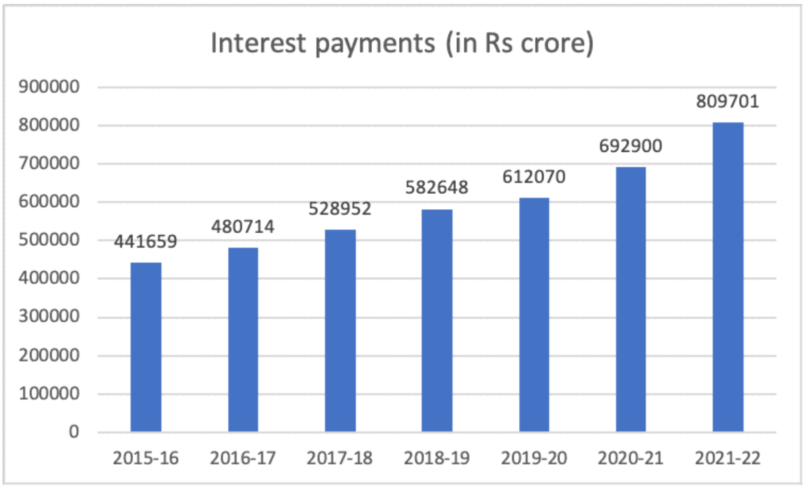

As I keep saying, the union budget at its heart is the presentation of the financial accounts of the government or to put it simply, on what it plans to spend money on, during the course of a year and how does it plan to *earn and arrange* for that money.

Given this, a lot of analysis happens on the issue of what the government plans to spend money on, during the course of a particular year. A similar thing has happened this time around as well, with journalists, analysts and economists, digging into the budget in trying to figure out where exactly is the government planning to spend money in 2021-22 and where it has spent its money in 2020-21.

The trouble is that like previous years this year as well most analysis has missed out on the biggest expenditure item in the government budget, which is interest payments. Almost every government spends more than what it earns and the difference is referred to as the fiscal deficit. This deficit is largely financed through the government borrowing by issuing bonds. An interest needs to be paid on these bonds every year.

This interest is the largest expenditure in the government's budget, even though it rarely gets talked about.

Take a look at the following graph, which plots the interest payments on the outstanding borrowing of the union government.



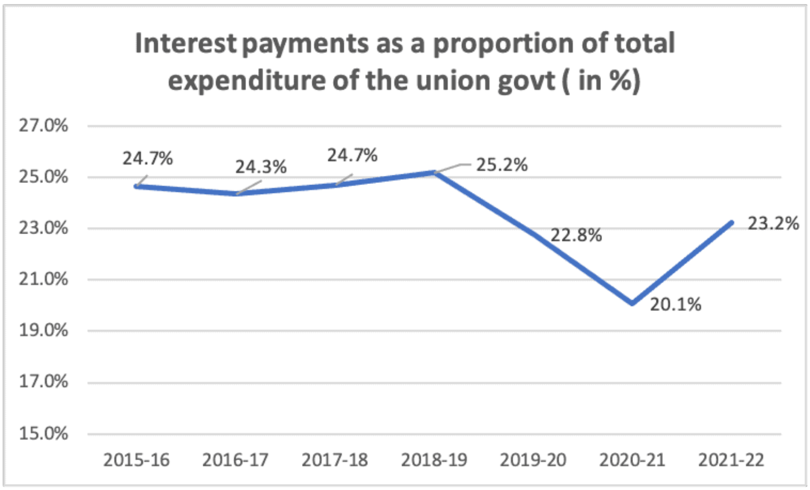

Source: Centre for Monitoring Indian Economy.

2020-21 – Revised estimate.

2021-22 – Budget estimate.

As can be seen from the above chart, the interest payments have been going up over the years and are expected to be at around Rs 8.1 lakh crore in 2021-22 . Now Rs 8.1 lakh crore on its own sounds like a large number, but just looking at the absolute number is not the right way to go about things in this case.

Let's look at what proportion of overall expenditure of the union government have interest payments formed over the years.

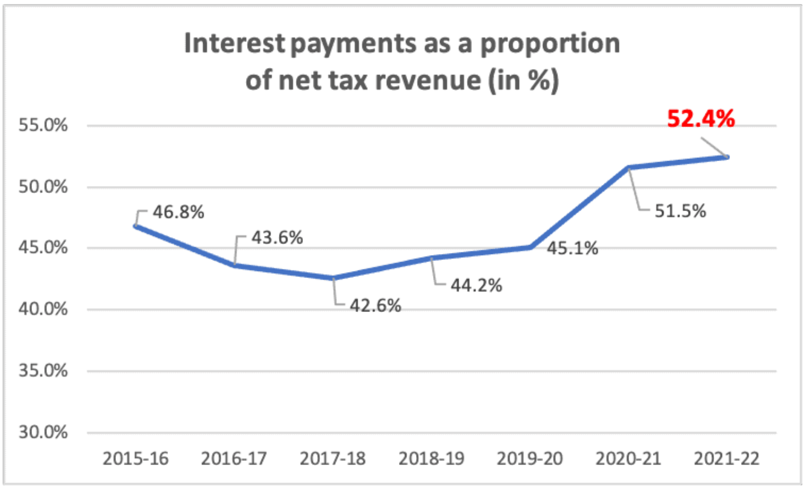



Source: Author calculations on data from Centre for Monitoring Indian Economy.

As per this graph, interest payments in 2020-21 formed a little over one-fifth of total expenditure and this is an improvement on the situation that prevailed before. But this interpretation is wrong, simply because the overall expenditure of the government also includes money that it does not earn.

Hence, a government can always borrow more and spend more in a particular year leading to a higher expenditure number and thus, the interest payments as a proportion of overall expenditure will come down. But that doesn't mean things have improved.

Let's look at another chart. This plots the interest payments as a proportion of net tax revenue earned by the union government. Net tax revenue is what remains with the central government after sharing a certain proportion of the gross tax revenue (or to put it simply overall tax collections) with the state governments.




Source: Author calculations on data from Centre for Monitoring Indian Economy.

The above chart gives us a clear picture of the prevailing situation. In 2017-18, the interest payments formed 42.6% of the tax revenues earned by the union government. They have been rising since then and in 2020-21 and 2021-22 are expected to touch 51.5% and 52.4%, respectively.

What does this mean? It means that more than half of the government's taxes are going towards paying interest on its outstanding loans, leaving very little money for anything else, unless the government earns money through other ways or borrows money or uses other ways to finance the fiscal deficit.

One way for the government to earn more money is through the sale of its stakes in public sector enterprises. In 2020-21, the government had hoped to earn Rs 2.1 lakh crore through this route. This turned out to be a very ambitious target and the government is now hoping to earn Rs 32,000 crore through this route during 2020-21.

The disinvestment target for 2021-22 has been set at Rs 1.75 lakh crore. It is very important for the government to earn this money else it will have to borrow more to meet the expenditure. This will mean higher interest payments in the years to come which will either lead to the government having to cut expenditure or having to borrow even more to meet the expenditure. More borrowing will lead to even more interest on the outstanding debt.

This will have to be paid by implementing higher taxes on the taxpayers and many of these taxpayers will be newer ones, just entering the workforce. This is precisely the way the current generation passes on its liabilities to the next one.

Also, as the outstanding debt matures and needs to be repaid, the government will have to borrow more to repay this debt. Hence, a greater proportion of the borrowing will just go towards repaying debt which is maturing. This will become a debt spiral and needs to be best avoided.

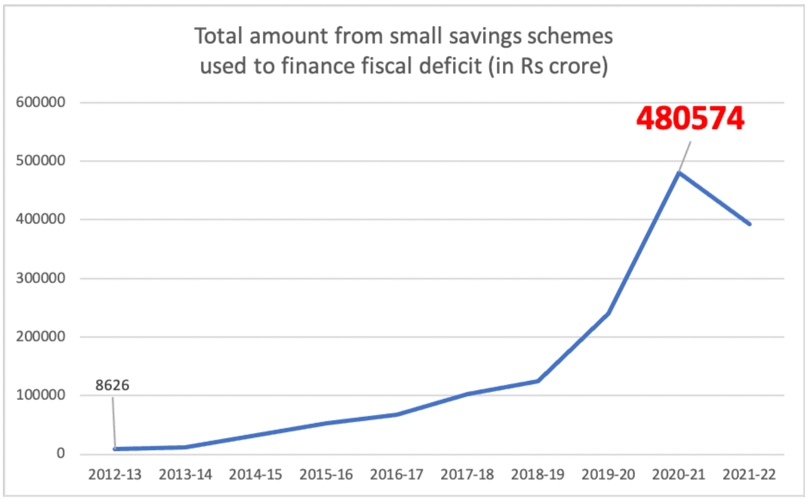
There is another thing that is happening and needs to be brought to notice. The government finances a major part of the fiscal deficit through borrowing. So, let's take the case of 2020-21. The fiscal deficit for the year is expected to be at Rs 18.49 lakh crore.

A bulk of this deficit will be financed by borrowing Rs 12.74 lakh crore from the market. Where does the remaining money to fill the gap come from? A bulk of it comes from the small savings schemes.

The small savings schemes currently in force are: Post Office Savings Account, National Savings Time Deposits ( 1,2,3 & 5 years), National Savings Recurring Deposits, National Savings Monthly Income Scheme Account, Senior Citizens Savings Scheme, National Savings Certificate, Public Provident Fund, KisanVikas Patra and Sukanya Samriddhi Account.

The money coming into these schemes net of disbursements that happen during the course of the year, is used to finance the fiscal deficit of the union government.

This has been rising at an astonishing pace over the years, as can be seen from the following chart.



Source: Centre for Monitoring Indian Economy.

In 2012-13, the amount had stood at Rs 8,626 crore and it has since risen to more than Rs 4.80 lakh crore. While this amount does not end up as a debt of the government, it is a liability that the government does need to repay over the years.

Also, this is money that is coming from the public savings at the end of the day. In order to ensure that money keeps coming into these schemes, the government will have to continue offering a higher rate of interest on these schemes in comparison to bank fixed deposits.

Hence, the perpetual complaint of the bankers is likely to stay, given that the government needs this money to continue financing its high fiscal deficit. The other option is to borrow directly from the market and increase its outstanding debt figure, which the government wants to avoid beyond a point.

What this tells us is that all hasn't been well on the government finances front over the last few years, and covid has only made it worse. One reason for this lies in the constant fall in the taxes collected by the government as a proportion of the gross domestic product (GDP), over the years.

The net tax revenue of the union government stood at 8.97% of the GDP in 2007-08. It has since fallen and was at 6.67% of the GDP in 2019-20. In 2020-21, it is expected to be at 6.90% of the GDP. The figure is higher in 2020-21 simply because of the size of the Indian economy, as represented by the GDP, is expected to *contract more* than the taxes collected by the government during the year.

This fall in tax collections and the dependence of the government on other ways of financing its fiscal deficit, also leads to the question whether the size of the Indian economy or its GDP, is being properly measured. Over the years, the informal part of the Indian economy has seen huge destruction and the question is, does this destruction reflect properly in the GDP figures being published over the years. This is a question well worth asking given that if the GDP is growing why have tax collections been falling?

To conclude, it does seem the government understands the financial situation it is headed towards. Hence, an ambitious target for disinvestment has been set. Over and above this, it also has plans of monetising physical assets including surplus land. Hopefully, this will take off soon. .

PS: Of course, you will not find this kind of analysis anywhere in the mainstream media or even digital publications which charge a fee. Hence, it is important that you support my work. You can do it here.

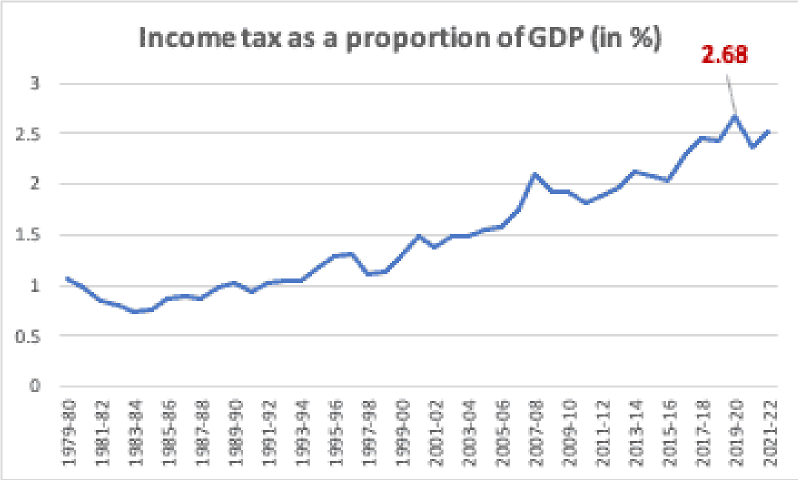
8 February, 2021

# Why Govt Loves Income Tax and Isn't Going to Scrap It


One suggestion that I see people constantly make on the social media, particularly on Twitter, is that the government should do away with personal/individual income tax. They often say this with a lot of confidence, giving the impression that they have thought through the argument. Over the last one week, since the presentation of the annual budget of the union government, such suggestions seem to have made a comeback.

But the confidence of the people making these suggestions *largely* comes comes from two things. One is that they haven't had a look at the government data on taxes, which leads them to believe that barely anyone pays income tax and hence, it should be scrapped. Two, they have no idea as to how most governments operate.

Let's take a look at a few charts to understand why this logic is all wrong. The following chart plots the individual income tax collected by the government as a proportion of the Indian gross domestic product (GDP), a measure of the size of the economy.




Source: Centre for Monitoring Indian Economy.

Revised estimate for 2020-21.

Budget estimate for 2021-22.

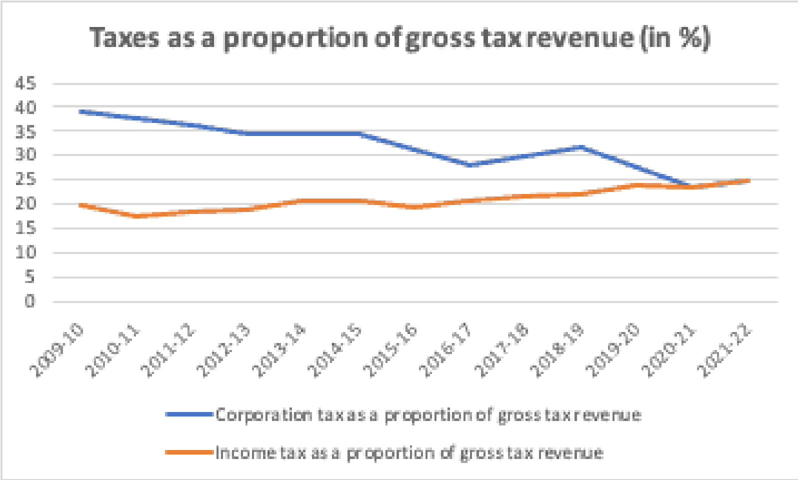
As can be seen from the above chart, income tax as a proportion of GDP has *only* gone up over the years. In 2019-20, it peaked at 2.68% of the GDP. In 2020-21, thanks to the economic contraction due to the spread of the covid pandemic and falling incomes, the income tax to GDP ratio is expected to be at 2.36% of the GDP. It is expected to rise again to 2.52% of the GDP in 2021-22.

The typical argument suggesting that the government should do away with income tax, goes somewhat like this. Oh, but very few people pay income tax. Now that is true, but that hardly means that the government will stop collecting income tax.

A slightly more sophisticated argument (at least the person making it, feels it is a sophisticated argument) goes somewhat like this. Oh, but income tax collected forms just *a couple of percentage points of the GDP* . That's nothing.

Honestly, I find both these arguments hilarious. Guys making these arguments have no idea about how the data looks and as I said, which is where their confidence comes from.

Let's look at the following chart, which basically plots corporation tax (income tax paid by corporates on their profits) and personal income tax as a proportion of gross tax revenue, over the years. Gross tax revenue is basically the sum of different taxes (corporation tax, income tax, union excise duty, customs duty, central goods and services tax etc.), earned by the union government.




Source: Centre for Monitoring Indian Economy.

What does the above chart tell us?

**1)** The corporation tax collected as a proportion of the total taxes collected by the government, has been falling over the years. In 2009-10, corporate taxes formed around two-fifth of the total taxes collected by the government. In 2021-22, the tax is expected to be at around one-fourth of total taxes. There are multiple reasons for this. Corporate revenue growth has slowed down over the years. Along with that corporate tax rates have also come down.

**2)** The importance of income tax in the overall taxes earned by the government has gone up in the last decade. In 2009-10, they formed around one fifth of total taxes and in 2021-22, they are expected to form around one fourth of the gross tax revenue earned by the union government. In 2019-20, income tax formed around 23.9% of overall taxes.

Hence, all taxes may appear small as a proportion of the GDP, but that does not mean that they are not important for the government. The government isn't the entire economy as represented by the GDP but only a part of it and the taxes earned are a part of that part.

Now tell me which government in its right mind is going to drop a tax which is likely to bring in one-fourth of the total taxes earned by it. This especially in an environment where corporation tax collections as a proportion of the GDP have been falling over the years.

Another argument that is made is that income taxes should be eliminated and indirect taxes should be raised. So, with no income tax, people will earn more and hence, spend more, and the government will end up collecting more indirect taxes, and these taxes will more than make up for a loss of income tax.

While this sounds good in theory, the trouble is that unlike the physical sciences, in economics you cannot carry out real life experiments. So, no government is going to risk one-fourth of its revenue just because in theory they could do something else. Nah, not going to happen. The whole argument rests on the idea that if income tax is done away with people are *likely* to spend more. What if they don't and decide to *save* more? There is no way of knowing in advance about how people are going to behave.

Actually, a more refined argument can be made here. People who pay a bulk of India's income taxes already have most things that they need in life. Hence, their marginal propensity to consume will be low. This means that the extra money they earn thanks to lower taxes, they are more likely to save/invest it than spend it.

Hence, the argument that people are likely to spend more because they will earn more thanks to no income tax, doesn't really hold. One thing that can be said for sure here is that if income tax is done away with, the stock market will go through the roof (not that it isn't already).

A better way to increase consumption and hence, indirect tax collections is to reduce goods and services tax on mass produced goods. The impact is going to be much greater in this case.

There are other reasons here as well. There is a huge income tax bureaucracy in place. What happens to those people with no income tax? Income tax is also used by politicians in power to *harass* those in opposition or other people opposing them. Why let go of such an option?

All in all, income taxes are not going anywhere, even though when the BJP was in the opposition, it was pretty vocal on the issue of doing away with them.

But now they need to run the country and the gross tax revenue collected by the government, has come down over the years. The gross tax revenue as a proportion of the GDP peaked at 12.11% in 2007-08. In 2019-20, it was at 10.61%. It is expected to fall to 9.75% of the GDP this year and rise to 9.95% of the GDP next year, still significantly lower than the all-time peak level.

So, next time you want to go shouting on Twitter asking the government to do away with personal income tax, please do remember these points.

4 February, 2021

# Budget 2021: Govt's Claim of a Sharp Increase in Capital Expenditure Doesn't Really Hold

Good analysis takes time.

It's been three days since the finance minister Nirmala Sitharaman presented the annual budget of the union government and now my brain has really opened up and can see things that it couldn't earlier.

On February 2, I wrote a piece which basically looked in detail at the fiscal deficit of 9.5% of the gross domestic product (GDP) and why the government's claim of spending more this year and the next, to become the *spender of the last resort* and get the economy going again, didn't really hold.

This piece is basically an extension of the same idea. Ideally, you should read the February 2 piece before you read this. Nevertheless, this piece is also complete on its own and if you are short on time, then just reading this piece should be enough to understand what I am trying to say.

One of the claims made by the finance minister in her budget speech was that the government was i *ncreasing the capital expenditure this year and the next.* The mainstream media and the stock market wallahs have also *tom tommed* this line over the last few days. Nevertheless, as my analysis shows, this claim doesn't really hold to the extent it is being made out to be.

As the finance minister said in her speech:

> *"In the BE 2020-21, we had provided Rs 4.12 lakh crores for capital expenditure. It was our effort that in spite of resource crunch we should spend more on capital and we are likely to end the year at around Rs 4.39 lakh crores which I have provided in the RE 2020-21. For 2021-22, I propose a sharp increase [emphasis added] in capital expenditure and thus have provided Rs 5.54 lakh crores which is 34.5% more than the BE of 2020-21."*

Let's try and understand what the finance minister is saying here pointwise. (BE = budget estimate. RE = revised estimate. When the budget is presented a budget estimate is made. When the next budget is presented a revised estimate is put forward).

**1)** Capital expenditure is basically money spent on creating assets, in particular physical infrastructure like roads, railway lines, factories, ports, etc. Revenue expenditure is basically money spent in paying salaries and pensions, financing subsidies, etc. Over and above this, interest paid on the outstanding debt or borrowings of the government, is also a part of revenue expenditure. In fact, interest payments on outstanding debt are the biggest expenditure in the union budget. In 2020-21, it forms 20% of the total government expenditure and it jumps to 23.3% in 2021-22.

The usefulness of capital expenditure made by the government can be experienced in the years to come as well and it is believed that it adds to economic activity more than the revenue expenditure. Hence, economists, journalists and policy analysts, while analysing the union budget like to look at the money that has been allocated towards capital expenditure.

**2)** In 2019-20, the government spent Rs 3.36 lakh crore on capital expenditure. In 2020-21, it is expected to end up spending Rs 4.39 lakh crore, which is 30.7% more. But the thing to understand here is that when the government presented the budget for this financial year in February 2020, it had already budgeted to spend Rs 4.12 lakh crore or around 22.6% more.

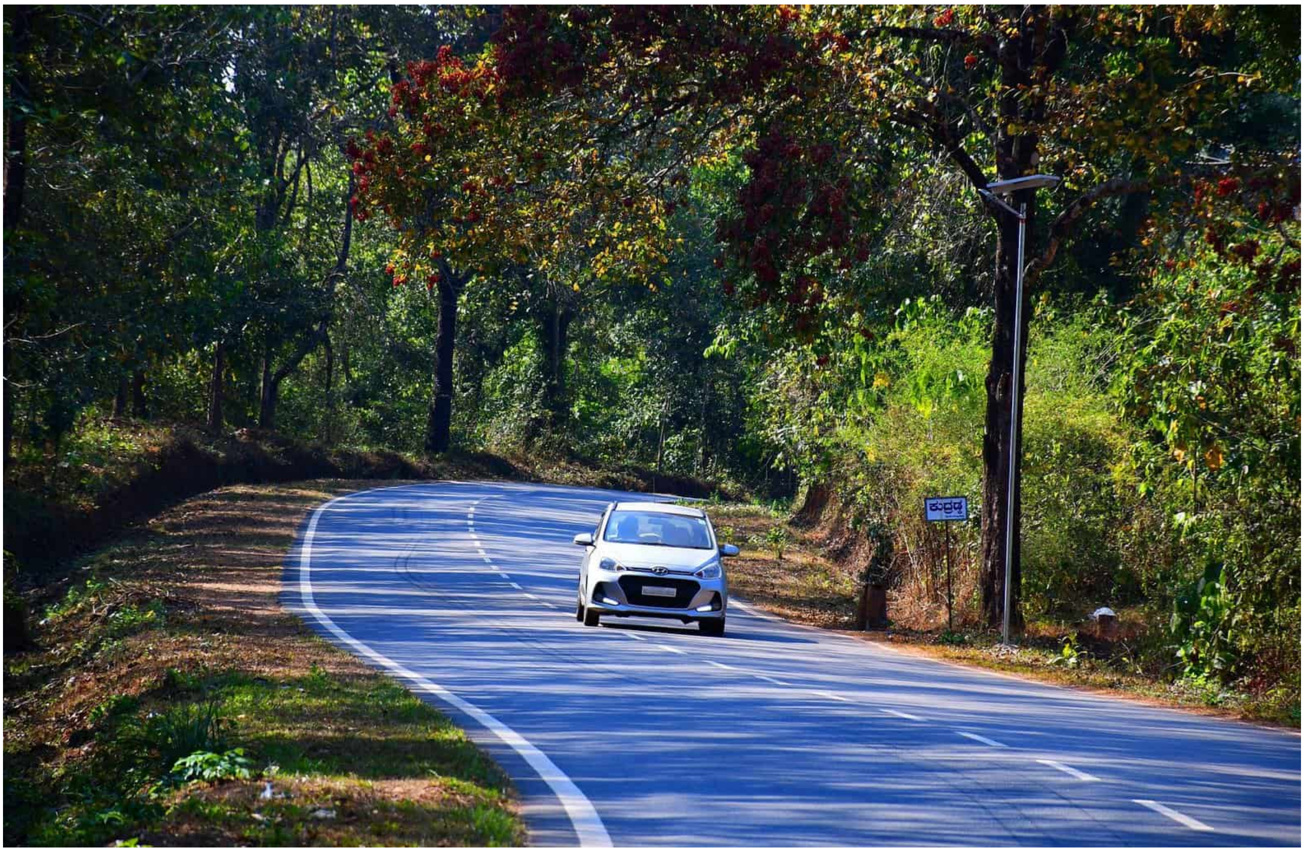
It is worth remembering that when the budget for this financial year was presented, the fear of covid and the negative impact it would have on the economy, hadn't been realised as yet. In the aftermath of covid, the capital expenditure went up from the budgeted Rs 4.12 lakh crore (or the budget estimate) to the revised estimate (RE) of Rs 4.39 lakh crore. Hence, the post covid increase in capital expenditure has been around 6.6%.

Given this, the increase in capital expenditure in 2020-21 had already been budgeted for pre-covid and there was a small increase post-covid. Once we know this, things don't sound as exciting as the finance minister made it sound in her budget speech.

**3)** How will things look in 2021-22 when it comes to capital expenditure? The finance minister said that the capital expenditure will grow by 34.5% to Rs 5.54 lakh crore in 2021-22 in comparison to the budgeted expenditure of Rs 4.12 lakh crore in 2020-21.

The question is why would you compare next year's budget estimate with the current year's budget estimate when the revised estimate number for the year is already available. You would only do it, if you wanted to show a higher jump. Anyway, the finance minister of a country should be using *some better mathematical tricks* than such an elementary one.

Also, even when we compare next year's budgeted capital expenditure with this year's revised one, the jump is substantial. The capital expenditure will jump from Rs 4.39 lakh crore to Rs 5.54 lakh crore. This is a jump of 26.2%, which looks to be very good.



**4)** So far so good. The trouble is that the finance minister just spoke about the budgeted capital expenditure of the government in her budget speech and not the total capital expenditure of government. You can click on this and go to page 8 to get the numbers for the total capital expenditure of the government, which are also published in the budget.

The total capital expenditure of the government includes what is in the budget plus internal and extra budgeted resources (IEBR). The IEBR consists of money raised by the public sector enterprises owned by the union government through profits, loans as well as equity, for capital expenditure. It also includes the Indian Railways. This is also a part of government's overall capital expenditure though it is off-budget and not a part of it.

The total capital expenditure of the government in 2019-20 stood at Rs 9,77,280 crore (It will soon become clear why I am using full numbers and not representing them in lakh crore). The revised estimate for the total capital expenditure in 2020-21 stood at Rs 10,84,651 crore, which is around 11% more. A 11% jump year on year sounds decent.

Nevertheless, one needs to take into account the fact that the budgeted capital expenditure of the union government when the budget for this year was presented in February 2020 had stood at Rs 10,84,748 crore.

As I said earlier, the budget was presented before covid struck. In that sense, the revised capital expenditure of 2020-21 is actually *slightly* lower than the budgeted one. This again punctures the government's claim of spending more to get the economy going again post covid. They are spending a tad lower than what they had planned to spend before covid struck.

**5)** How does 2021-22 look? The government is planning to spend Rs 11,37,067 crore towards capital expenditure. This is 4.8% more than the current financial year. This when the government expects the nominal gross domestic product (GDP), not adjusted for inflation, to jump by 14.4% during 2021-22. The Economic Survey expects the nominal GDP to jump by 15.4%.

Once this is taken into account, it is safe to say that if the government sticks to these numbers, there will be barely any increase in capital expenditure between this year and the next.

Of course, the narrative of the government increasing its capital expenditure has been set. That's what we have been told over and over again over the last few days. The stock market seems to believe it as well.

This entire exercise also tells you how nuanced numbers can get once you start really digging them up and setting them up in the right context. This is something you won't see much in the mainstream media. Given this, it is very important that you please continue supporting my writing .

PS: I would like to thank, Sreejith Balasubramanian, Economist – Fund Management, IDFC AMC, whose research note on the budget, helped me think through this issue, in a much better way.

3 February, 2021

# Why a Billionaire Tax Doesn't Make Any Sense for Politicians


Incentives.

In the end everything boils down to it.

In the run up to the annual budget of the union government presented by the finance minister Nirmala Sitharaman, on February 1, many economic commentators suggested that the government should resort to a one-time billionaire tax.

The idea being that the stock market has rallied big time during the course of this financial year. Hence, while the income of the average Indian has fallen thanks to the economy contracting, the super-rich have become richer.

This one-time tax could fund a lot of extra expenditure in the budget in 2021-22, as the government tried to act as the *spender of the last resort* in an environment where private spending has slowed down and industrial expansion isn't happening at the same pace as it was.

If you are the kind who practices first level kind of thinking, this makes perfect sense. The rich have grown richer. So, let's take money from them and give it to those who need it. It also leads to greater equality, at least in your head. This kind of Robinhood thinking has prevailed for centuries. Hence, there is no reason for it to go away in 2021.

Nevertheless, if you are the kind who practices second level thinking and at the same time thinks about the incentives on offer, you would know that something like this doesn't make sense and is also *unlikely* to happen.

Let's try and understand this pointwise.

**1)** It is important to understand that billionaires don't have cash lying around to pay this tax. So, one way they would have raised cash to pay this tax would have been to sell some of their shares. Of course, given the *sudden* increase in supply of shares in the market could have led to the stock prices falling.

**2)** Actually, more than the billionaires selling their stake to pay up the tax, the stock market would have seen this move of the government in a negative way and sold off, even before billionaires would have started thinking about how to pay the tax. In fact, in the run up to the budget, the stock market did worry about new taxes and there was a sell off last week. This was its way of telling the government, please, *no new taxes* . It has been rising this week, since it realized that no news on the tax front is good news.

**3)** Currently, the government needs the stock market on its side, with its plans to raise Rs 1.75 lakh crore through the disinvestment route next year. And that is only possible if the stock prices continue to remain at high levels. Hence, it would have made no sense for the government to disturb the status quo. If the market would have fallen, it would have impacted the ability of the government to raise the amount of money it wants to through disinvestment. This would have, in turn, impacted its ability to spend.

**4)** These were the near-term reasons. But there are more issues at play here. Most Indian billionaires finance political parties both on record and off record. In their eyes they are already paying a billionaire tax. A lot of this money finds its way into the economy and is spent, during election time. In that sense, billionaire money is pump priming some part of the Indian economy all the time, given that elections to state governments happen every year.

Of course, no billionaire does this as a social service. They are looking for a quid-pro-quo from the government. That needs to be kept in mind as well.

**5)** It's important to look at this entire idea from the point of view of the incentive at play for a politician as well. Politicians exist to win elections. For this they need money, a massive amount of it. They can't win elections by spending money within the limits set by the Election Commission. Where does this money come from? To a large extent from billionaire businessmen who operate in spaces where they need to deal with government all the time. Hence, why would any politician in his or her right mind try to disturb this equation by irritating the main funders through a high one-time income tax. It just doesn't make any sense.

**6)** Finally, a high-income tax, one-time or otherwise, is always a bad idea. One it leads to a narrative of inconsistent tax policy, which the Indian government anyway suffers from. Two, it also leads to high income earners, who can leave the country to leave the country, and move to tax havens. The highest income tax rate in the country currently is greater than 40%. Hence, not surprisingly, a whole bunch of high-income earners have moved or want to move to places like Dubai. This obviously means they no longer pay their income tax in India.

Given these reasons a billionaire tax didn’t make any sense. Having said that, there is a case for clear rationalization of tax rates that is needed. You can’t have a small proportion of the salaried paying the highest marginal rate of more than 40% or even 30%, whereas those who can use the benefit of indexation while paying income tax, not paying any tax at all or a very low rate of tax. This needs to be corrected.

2 February, 2021

# "We have spent, we have spent and we have spent" – But Where Madam FM?


Those of you who read me regularly would know that I look at the government budget more as a statement of financial accounts and not much as an actual policy document, as many people do.

The reason is simple. The government has an opportunity to do right policy 365 days a year. But the annual budget numbers are released only once a year.

Keeping this in mind, in this piece I will look at the massive fiscal deficit that the union government will run this year and try to  analyse it in different ways and try connecting it to what it means for the economy as a whole and the ability of the government to spend money.

We will also look at whether the government is spending more money in order to get the economy going, as it has claimed to.
Let's take a look at this pointwise.

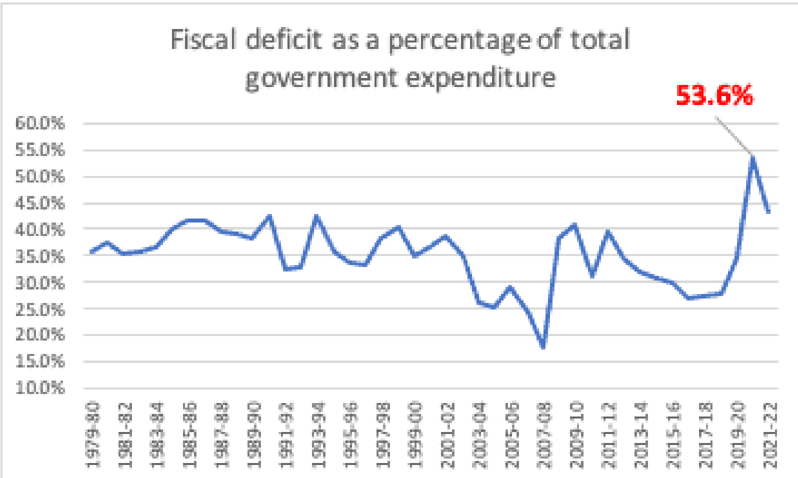
**1)** The fiscal deficit for 2020-21 is projected to be at 9.5% of the gross domestic product (GDP). This is the highest fiscal deficit figure between 1970-71 and now (The fiscal deficit data is available in the Centre for Monitoring Indian Economy database from 1970-71 onwards). While this shouldn't be surprising, the spread of the covid pandemic is not the only reason for it.

Fiscal deficit is the difference between what a government earns and what it spends and it is expressed as a percentage of GDP. Somehow, once expressed as a percentage of GDP, the fiscal deficit never sounds big enough.

In absolute terms, the fiscal deficit for this year is expected to be at Rs 18.49 lakh crore. Now that is one big number. Especially if you compare it to the fact that the fiscal deficit expected when the budget for this year was presented in February 2020, was Rs 7.96 lakh crore. The deficit turned out 132% more than what was forecast before the year began.

**2)** There is another interesting way to look at fiscal deficit. You might think that I am torturing numbers here and you are right to some extent, but I am only trying to show how big this fiscal deficit actually is.

Take a look at the following chart. It plots the fiscal deficit as a percentage of total government expenditure, over the years.




Source: Author calculations on data from Centre for Monitoring Indian Economy.

What does this chart tell us? It tells us that in 2020-21, the fiscal deficit as a percentage of government expenditure will be at 53.6%. This is the highest ever level. Hence, a bulk of the government expenditure during 2020-21 will not be financed by its earnings. This tells us how high the fiscal deficit really is.

**3)** The question is why has the fiscal deficit jumped to such a high level? The simple answer is that the government hasn't earned the total amount of tax it had projected, thanks to the spread of the covid pandemic. Let's start with the net tax revenue or what is left after the government has shared the tax collected with the state governments.

The government expected to earn a net tax revenue of Rs 16.36 lakh crore this year, when the budget for this year was presented in February 2020. It now hopes to earn Rs 13.45 lakh crore. This is Rs 2.89 lakh crore or 17.8% lower. This explains a part of the jump in the fiscal deficit from an expected level of Rs 7.96 lakh crore to Rs 18.49 lakh crore. But it still doesn't give us the complete story.

**4)** In 2020-21, the government expected to earn a significant amount of money by selling or disinvesting its stakes in public sector enterprises. The amount it expected to earn through disinvestment was Rs 2.1 lakh crore. It has now been revised to just Rs 32,000 crore or 15.2% of the expected amount. There is gap of Rs 1.78 lakh crore here and this has also majorly pushed up the fiscal deficit.

The government's excuse for this is covid. While, that might have been true for the first half of the year, it just doesn't work for the second half of the year, when the stock market has gone from strength to strength and the government could easily have divested its stakes in public sector enterprises.

The only possible explanation here is that the government, as usual, has moved very very slowly on the procedural formalities required to disinvest its stakes in public sector firms.

**5)** A lower tax collection of Rs 2.89 lakh crore and lower disinvestment receipts of Rs 1.78 lakh crore, still only add up to around Rs 4.67 lakh crore and doesn't totally explain the huge jump in the fiscal deficit.

There is a third major reason. I write about it in detail here . And I urge you click on this link and read it. I will offer a short summary here. The Food Corporation of India (FCI) buys rice and wheat directly from farmers at a minimum support price announced by the government. It then sells this rice and wheat through the public distribution system at a much lower price, in order to meet the needs of food security.

The government has to compensate the FCI for this difference. It does that by allocating money towards food subsidy in the budget. Over the years, the money allocated towards food subsidy has never been enough. In 2019-20, the FCI 's food subsidy bill was close to Rs 3.18 lakh crore. The government gave it Rs 75,000 crore.

Much of this gap was filled by FCI taking on loans from the National Small Savings Fund, where all the money collected under the various small savings schemes, ends up. As of March 2020, the FCI owed NSSF Rs 2.55 lakh crore.

The accounting jugglery over the years, essentially helped the government to declare a lower expenditure and hence, a lower fiscal deficit.

The government has now decided to end this and take on the total food subsidy offered by FCI as an expenditure. Hence, in February 2020, when the budget for this year was presented the allocation of food subsidy to FCI had stood at Rs 77,983 crore. It has now been revised to Rs 3.44 lakh crore. In fact, the overall food subsidy has been increased from Rs 1.16 lakh crore to Rs 4.23 lakh crore. This is a good thing that has happened because ultimately the main aim of the government budget is to present financial accounts as correctly as possible.

This has added Rs 3.07 lakh crore (Rs 4.23 lakh crore minus Rs 1.16 lakh crore) more to the government expenditure and hence, to the fiscal deficit as well. Hence, the three reasons discussed up until now increased the fiscal deficit by Rs 7.74 lakh crore (Rs 2.89 lakh crore + Rs 1.78 lakh crore + Rs 3.07 lakh crore). This still doesn’t explain the total difference.

**6)** Other than taxes and disinvestment, the government also earns money under the heading non tax revenue. This includes dividends that the government earns from public sector enterprises, public sector banks, financial institutions like the Life Insurance Corporation of India and the dividend from the Reserve Bank of India. It also includes many other ways of making money.

The non tax revenue that the government had hoped to earn this year was Rs 3.85 lakh crore and it ended up earning Rs 2.11 lakh crore, which was Rs 1.74 lakh crore lower. This was primarily on account a massive fall in dividends earned.

If we add this to the earlier Rs 7.74 lakh crore, we get Rs 9.48 lakh crore. The fiscal deficit went up from a projected Rs 7.96 lakh crore to Rs 18.49 lakh crore primarily because of these four reasons.

Three of these reasons, lower tax collections, lower disinvestment receipts and lower non tax revenue, are on the earnings side. And one reason, higher food subsidy is on the expenditure side.

**7)** The finance minister Nirmala Sitharaman in her post budget interaction with the media said the government has spent a lot of money in order to get the economy going. The Business Standard reports her as saying , *we have spent, we have spent and we have spent* . The logic here is that in an environment where personal consumption has slowed down and industrial expansion is not happening, the government has to become the spender of the last resort, in order to get the economy going again.

The business media today is full of headlines around the government spending its way out of trouble. But do the budget numbers really reflect that?

Let's try and see what the numbers tell us. The total government expenditure budgeted for 2021-22 is Rs 34.83 lakh crore. This is just a little more than the Rs 34.5 lakh crore the government expects to spend this year.

Here's the interesting thing. In 2021-22, the government expects to spend Rs 8.1 lakh crore on paying interest on its outstanding debt. Once we adjust for this, the total government expenditure in 2021-22 stands at Rs 26.73 lakh crore (Rs 34.83 lakh crore minus Rs 8.1 lakh crore).

In 2020-21, the government expects to spend Rs 6.93 lakh crore on paying interest on its debt. Once we adjust for this, the total government expenditure in 2020-21 stands at Rs 27.57 lakh crore (Rs 34.5 lakh crore minus Rs 6.93 lakh crore).

Hence, the year on year, overall government spending next year will actually come down and not go up. Having said that, the capital expenditure in 2021-22 is budgeted to be at Rs 5.54 lakh crore, which is 26.2% more than the Rs 4.39 lakh crore, the government expects to spend in 2020-21. This is some good news, but doesn't deserve the emphatic *spend, spend, spend* , statement.

The extra Rs 1.15 lakh crore (Rs 5.54 lakh crore minus Rs 4.39 lakh crore) works out to 0.5% of the GDP projected for 2021-22. While something is better than nothing, it clearly isn't much.

**8)** What about the current financial year? The government plans to spend a total of Rs 34.5 lakh crore. This is 13.4% more than the Rs 30.42 lakh crore it had planned to spend when it presented the budget. Once we adjust for the fact the food subsidies have been properly accounted for and that has added Rs 3.07 lakh crore to the government expenditure, the actual expenditure goes down to Rs 31.43 lakh crore (Rs 34.5 lakh crore minus Rs 3.07 lakh crore). This is around 3.3% more than the amount budgeted of Rs 30.42 lakh crore, at the time of the presentation of the budget.

In fact, if we look at the food subsidy paid during April to December 2020, it amounts to Rs 1.25 lakh crore. With the budgeted amount being at Rs 4.23 lakh crore, close to Rs 3 lakh crore of food subsidy still remains unpaid. This will be paid during the last three months of 2020-21.

This money has already been spent by FCI and other agencies during this year and years gone by. Once FCI receives this money, it will pay off the money it owes to NSSF. Hence, there is really no extra spending happening here.

**9)** Now let's compare, the spending in 2020-21 with that in 2019-20. The total expenditure in 2019-20 had stood at Rs 26.86 lakh crore. Once we take the increase in food subsidies out, the total expenditure in 2020-21 stands at Rs 31.43 lakh crore (Rs 34.5 lakh crore minus Rs 3.07 lakh crore). The spending in 2020-21 is thus around 17% more than the last financial year. But much of it was budgeted for in February 2020, when the budget for this year was first presented.

Hence, the increase in spending in 2020-21, or the *fiscal stimulus* as economists like to call it, hasn't been because of the covid pandemic, it was happening anyway.

To conclude, it is clear that the government is not spending more in 2021-22 on the whole, though there is some increase in capital expenditure and that's good. In 2020-21, the government has actually spent more, but then much of it was planned before covid and not after it.

It also tells us that once we take the real fiscal deficit into account, there isn't much that the government can do to spend its way out of trouble. The good thing is that the government has decided to clean up its books. And that will have repercussions on the total amount of money it is able to spend during the course of this year and the next. The mistakes that we make in our past always come back to haunt us.

Dear Reader, clearly this piece should tell you how nuanced numbers can get, if one decides to dig a little deeper. Of course, you won't get such a nuanced reading of the budget numbers anywhere in the mainstream media.

Hence, it is important that you continue supporting my work .

30 January, 2021

# Mr Chief Economic Advisor, Printing Money is Always a Bad Idea.

The Economic Survey for 2020-21 was published yesterday. I wrote a summary of the survey titled 10 major points made by the Economic Survey .

It wasn't possible to even speed-read the whole Survey quickly, hence, I missed out on a few points, and am writing about them here. This piece is a follow up and I strongly recommend that you read the first piece before reading this one.

Let's look at some important points made in the Survey.

**1)** The spread of corona has led to a massive economic contraction this year. While the growth is expected to bounce back over the next few years, the impact of this year's contraction isn't going to go away in a hurry.

As per the Survey, if India grows by 12% in 2021-22 and 6.5% and 7%, in 2022-23 and 2023-24, respectively, the Indian economy will be at around 91.5% of where it would have *possibly* been if there would have been no covid and no economic contraction, and India would have continued to grow at 6.7% per year on an average, as it has in the five years before 2020-21.

At 10% growth in 2021-22, and 6.5% and 7% growth in 2022-23 and 2023-24, respectively, the Indian economy will be at around 90% of where it could have possibly been, the Survey points out.

This is an important point that we need to understand. While, 2021-22 might see a double digit growth, covid has put us back by more than half a decade, if we look at trend growth.

**2)** The Economic Survey recommends money printing to finance higher government expenditure. Call me old school, but I always feel uncomfortable when economists recommend outright money printing to fund government expenditure. Of course, there is always a theoretical argument on offer.

The Survey refers to a speech made by Patrick Bolton, a professor of business at Columbia University in New York, to make the money printing argument and why money printing, where an excess amount of money chases a similar amount of goods and services, doesn't always lead to inflation.

As the Survey points out:

> *"Printing more money can result in inflation and loss of purchasing power for domestic residents if the increase in money supply is larger than the increase in output….Printing more money does not necessarily lead to inflation and a debasement of the currency. In fact, if the increased money supply creates a disproportionate increase in output because the money is invested to finance investment projects with positive net present value."*

What does this mean in simple English? The Survey is essentially saying that if the printed money is well utilised and put into projects which are beneficial for the society, it benefits everyone, and doesn't lead to inflation.

The trouble is a lot of things sound good in theory. One of the major things that the bad loans crisis of Indian banks teaches us is that the Indian system cannot take a sudden increase in investments. There is only so much that it can handle and that's primarily because there is too much red tapism and bureaucracy involved in getting any investment project going. We are still dealing with the fallout of this a decade later.

Also, how do the government and bureaucrats ensure that the amount of money being printed is just enough and will not lead to inflation. (Central planning keeps coming back in different forms).

The government can print money and spend it. This can ensure one round of spending and the money will land up in the hands of people. Also, as men spend money, this money will land up with shopkeepers and businesses all over the country. The shopkeepers may hold back some of the cash that they earn depending on their needs.

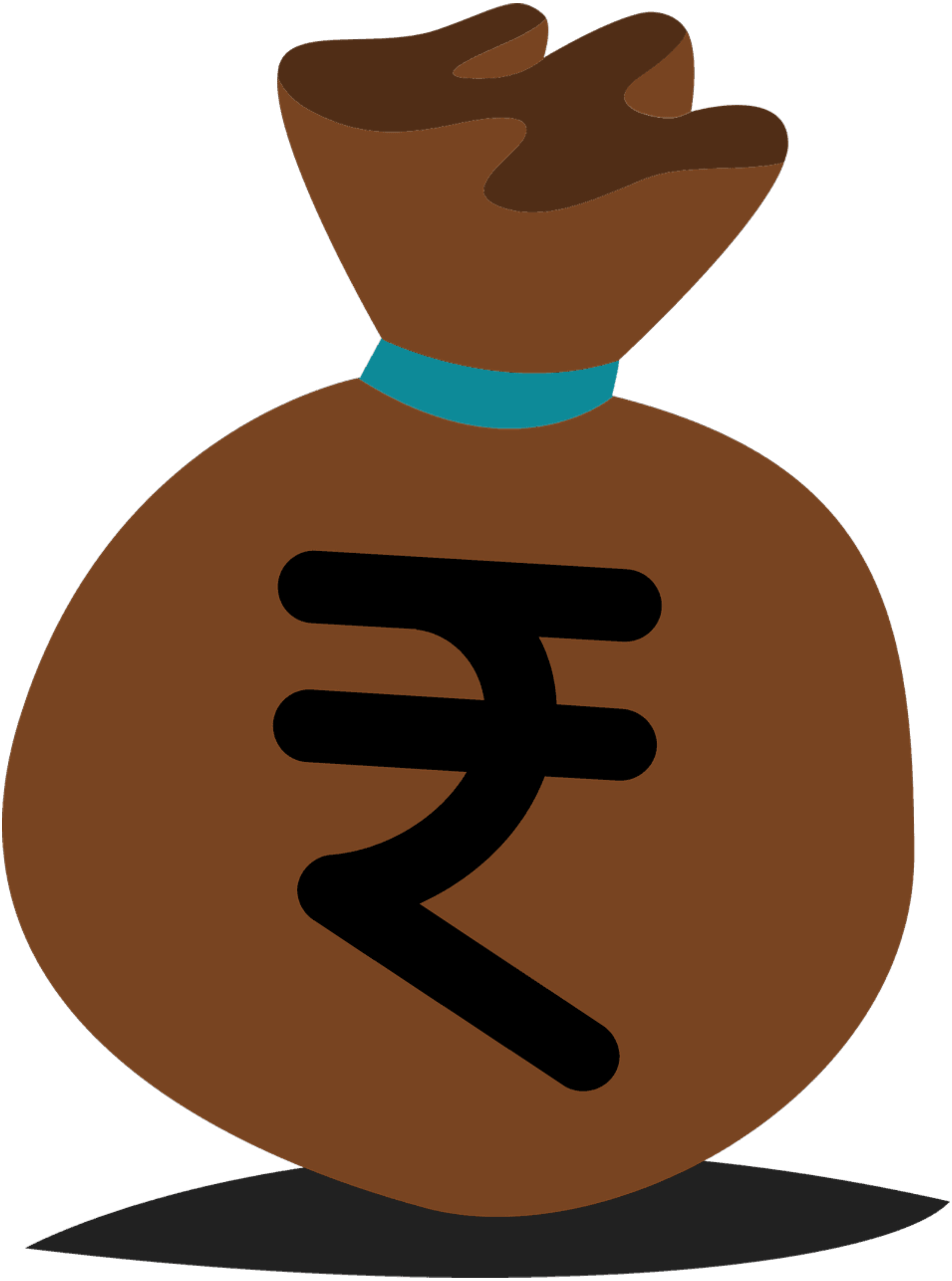
The chances are that most of this money will be deposited back into bank accounts. In the normal scheme of things, the banks would lend this money out. In difficult times, banks are reluctant to lend. Hence, they end up depositing this money with the RBI. The RBI pays interest on this money. As of yesterday, banks had deposited

Rs 5.6 lakh crore with the RBI. This is money they have no use for, or to put it in technical terms, this is the *excess liquidity* in the system.

Money printing will only add to this excess liquidity. Ultimately, for the economy to do well, people and corporates need to be in a state of mind to borrow and banks in the mood to lend. Printing money cannot ensure that.

Over and above this, money printing can and has led to massive financial and real estate bubbles, in the past few decades. This is asset price inflation. While this inflation doesn't reflect in the normal everyday consumer price inflation, it is a form of inflation at the end of the day. And whenever such bubbles burst, which they eventually do, it creates its own set of problems.

Given these reasons, the chief economic advisor Krishnamurthy Subramanian's recommendation of money printing by the government is a lazy idea which hasn't been thought through. (For a detailed argument against money printing, please read this ).



**3)** During the course of this financial year, banks have gone easy on borrowers who haven't been in a position to repay.

Technically, this is referred to as *regulatory forbearance.* In this case, the central bank, comes up with rules and regulations which basically allows banks to treat borrowers in trouble with kids gloves. One of the learnings from the bad loans crisis of banks has been that regulatory forbearance of the Reserve Bank of India, India's central bank, went on for too long.

The banks are yet to face the negative impact of the covid led contraction primarily because of regulatory forbearance. The banking system should be facing the first blows of the economic contraction. But that hasn't happened, thanks to the Supreme Court and regulatory forbearance. The Supreme Court, in an interim order dated September 3, 2020, had directed the banks that loan accounts which hadn't been declared as a bad loan as of August 31, shall not be declared as one, until further orders. Hence, the balance sheets of banks as revealed by their latest quarterly results, seem to be *too good to be true* .

The Survey suggests that an asset quality review of the balance sheets of banks may be in order. As it points out: "A clean-up of bank balance sheets is necessary when the forbearance is discontinued… An asset quality review exercise must be conducted immediately after the forbearance is withdrawn."

This is one of the few good suggestions in the Survey this year and needs to be acted on quickly, so as to reveal the correct state of balance sheets of banks. The Survey further points out: "The asset quality review must account for all the creative ways in which banks can evergreen their loans." Evergreening involves giving a new loan to the borrower so that he can pay the interest on the original loan or even repay it. And then everyone can just pretend that all is well.

In fact, even while making a suggestion for an asset quality review, the Survey takes potshots at Raghuram Rajan and the asset quality review he had initiated as the RBI governor in mid 2015.

**4)** Another point made in the Survey is to ignore the credit ratings agencies and their Indian ratings. As the Survey points out: "The Survey questioned whether India's sovereign credit ratings reflect its fundamentals, and found evidence of a systemic under-assessment of India's fundamentals as reflected in its low ratings over a period of at least two decades."

This leads the Survey to conclude: "India's fiscal policy must, therefore, not remain beholden to such a noisy/biased measure of India's fundamentals and should instead reflect Gurudev Rabindranath Thakur's sentiment of a mind without fear."

While invoking Tagore, the Survey basically recommends that India's government borrows more money to spend, taking into account "considerations of growth and development rather than be restrained by biased and subjective sovereign credit ratings". (On a slightly different note, who would have thought that one day an economist would invoke Rabindranath Thakur's name to market higher government borrowing).

Whether, the ratings agencies correctly rate India based on its fundamentals is one issue, whereas, whether it makes sense for India to ignore these ratings and borrow more, is another.

As the Survey points out: "While sovereign credit ratings do not reflect the Indian economy's fundamentals, noisy, opaque and biased credit ratings damage FPI flows." (FPI = foreign portfolio inflows).

What this means is that any further cut in credit rating can impact the amount of money being brought in by the foreign investors into India's stock and bond market. In particular, it can impact the long-term money being brought in by pension funds.

While, the Survey doesn't say so, it can *possibly* impact even foreign direct investment.

So, the point is, why take unnecessary *panga* , for the lack of a better word, with the rating agencies, at a point where the economy is anyway going through a tough time.

In another part, the Survey points out: "Debt levels have reached historic highs, making the global economy particularly vulnerable to financial market stress."

**5)** Given that, tax revenues have collapsed, government borrowing money to finance expenditure has gone up dramatically during the course of this year. As the Survey points out:

> *"As on January 8, 2021, the central government gross market borrowing for FY2020-21 reached Rs 10.72 lakh crore, while State Governments have raised Rs 5.71 lakh crore. While Centre's borrowings are 65 per cent higher than the amount raised in the corresponding period of the previous year, state governments have seen a step up of 41 per cent. Since the COVID-19 outbreak depressed growth and revenues, a significant scale up of borrowings amply demonstrates the government's commitment to provide sustained fiscal stimulus [emphasis added] by maintaining high public expenditure levels in the economy."*

Fiscal stimulus is when the government spends more money in order to pump up the economy in a scenario where individuals and corporates are going slow on spending. The total government spending during April to November 2020 stood at Rs 19.1 lakh crore. It has risen by just 4.9% in comparison to April to November 2019. Given that inflation has stood at more than 6% this year, this can *hardly* be called a fiscal stimulus.

To conclude, economic surveys in the past, other than offering a detailed assessment on the current state of the Indian economy, also used to do some solid thinking about the future or stuff that needs to be done on the economic front.

Over the past few years, a detailed reading of these Surveys suggests that they have become yet another policy document which feeds into government's massive *propaganda machinery* , albeit in a slightly sophisticated way.

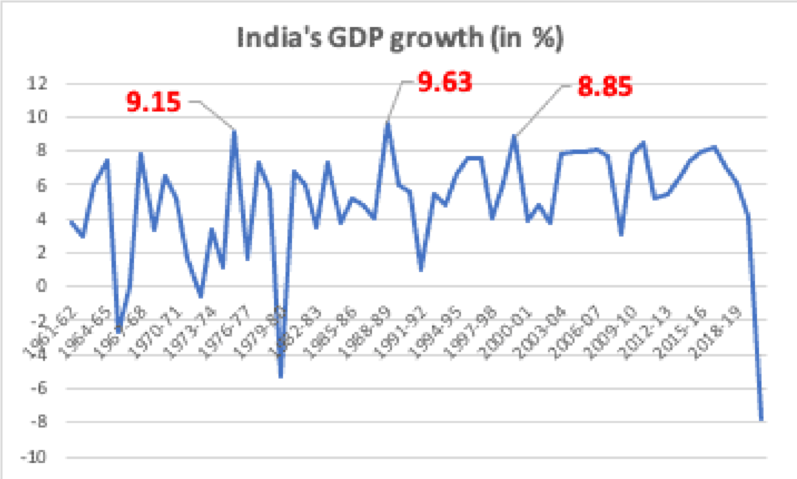
27 January, 2021

# IMF Says India Will Be Fastest Growing Economy in 2021, And That's Good News, But…

The International Monetary Fund (IMF) in the World Economic Outlook update for January 2021, has forecast that the Indian economy will grow by 11.5% in 2021.

If this happens, it will be the fastest that the Indian economy has ever grown. It will also be the first time that the Indian economy will grow in double digits. (Actually, the country did grow by greater than 10% in 2010-11, but that was later revised by the Modi government, once a new set of gross domestic product (GDP) data was published).

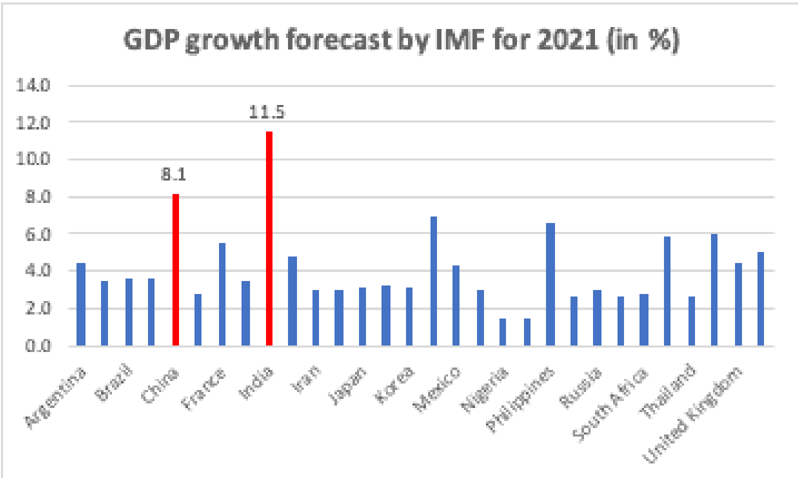
The following chart plots the GDP growth over the years. The GDP is the measure of an economic size of a country.




Source: Centre for Monitoring Indian Economy.

It is interesting that the Indian GDP has grown by more than 9% only twice previously, and both these occasions were before the 1991 economic reforms. The economy grew by 9.15% in 1975-76 (post the first oil shock) and 9.63% in 1988-89. Post 1991, the country grew the fastest in 1999-00 when it had grown by 8.85% (after the American sanctions).

Also, among the selected economies for which IMF published data, India will be the fastest growing economy in the world in 2021. China comes in second at 8.1%.




Source: International Monetary Fund.

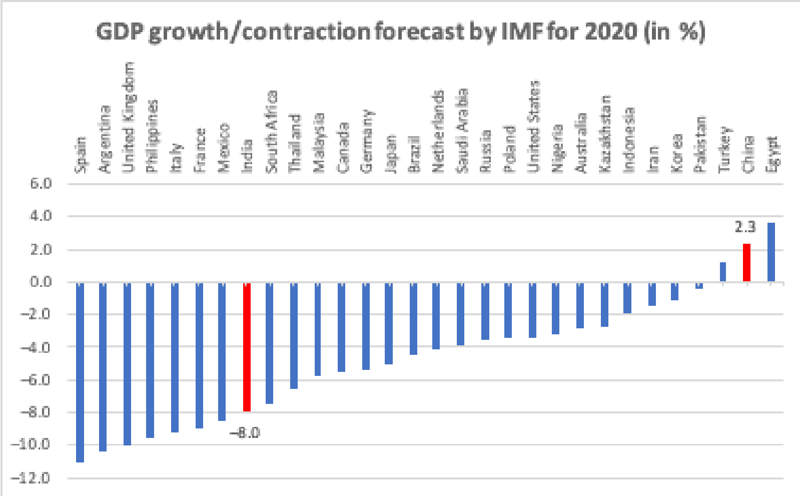
India growing by 11.5% in 2021 is indeed a big deal, there is no denying that. But there are a few factors that need to be kept in mind here.

First and foremost is the base effect. Before I go into highlighting the base effect in this context, let's first understand what it means.

Let's say the price of a stock in 2019 was Rs 100. In 2020, it falls by 50% to Rs 50. In 2021, it is expected to rise to Rs 75. This means a gain of Rs 25 or 50% per share. If we just look at prices of 2020 and 2021, the stock has done fantastically well and gained 50%.

But what we also need to keep in mind is the stock price in 2019, when it was at Rs 100. It then fell massively by 50% to Rs 50 and rose from there. Hence, the stock price rose from a much lower-base. And this lower base was responsible for a gain of 50%. Further, in 2021, the stock continued to be lower than its 2019 price. This is base effect at play.

One way to look at base effect is to look at the GDP growth/contraction forecast by IMF for 2020.




Source: International Monetary Fund.

As can be seen from the above chart, the IMF expects the Indian GDP to have contracted by 8% in 2020. Hence, in 2020, the Indian economy will be among the worst performing economies in the world. Given this, a 11.5% growth in 2021, will come on a massively contracted GDP in 2020. This is a point that needs to be kept in mind.

Also, all the countries which have done worse than India have a per capita income larger than that of India. In that sense they are economically much more developed than India is and their pain of contraction is much lesser than that of India, given that these countries already have access to the most basic economic necessities in life, which many Indians still don't.

Let's go into a little more detail on this point. While the IMF publishes real GDP growth data (which we have been discussing up until now), it doesn't publish constant price GDP , which adjusts for inflation, in a common currency like the US dollar.

To get around this problem, let's use the constant price GDP data published by the World Bank. On this we apply, the GDP contraction/growth rates as forecast by the IMF. As per the World Bank, the Indian GDP in 2019 (in constant 2010 $) was $2.94 trillion. In 2020. A contraction of 8% in 2020 would mean a GDP of $2.70 trillion in 2020. A 11.5% rise on this would mean that the Indian GDP is expected to touch $3.01 trillion in 2021, which is around 2.4% better than the GDP in 2019.

Hence, in that sense, the slowing Indian economic growth for the last few years, followed by the covid contraction, has put the Indian economy back by two years. Of course, it can be argued that every country has gone through this. Indeed, that's true, but that doesn't make our pain any better.

Also, before saying stuff like India will grow faster than China in 2021, please keep in mind the fact that the Chinese GDP in 2019 was $11.54 trillion (World Bank data), which is much more than that of the India's GDP.

In 2020, the Chinese economy was expected to grow by 2.3%. This means that the Chinese GDP in 2020 would have grown to $11.81 trillion. In 2021, the Chinese GDP is expected to grow by 8.1% to $12.76 trillion. This means an increase in GDP of $0.95 trillion in just one year. If we compare this increase with the expected Indian GDP of $3.01 trillion in 2021, what it means is that China will end up adding 31.6% of the India's economy in just one year. Or to put it simply, China will add a third of India's economy in just one year.

It also means that between 2019 and 2021, the Chinese economy is expected to grow by $1.22 trillion ($12.76 minus $11.54 trillion). During the same period, the Indian economy is expected to grow by $ 0.07 trillion ($3.01 trillion minus $2.94 trillion). Please keep these facts in mind before saying that in 2021 India will grow faster than China.

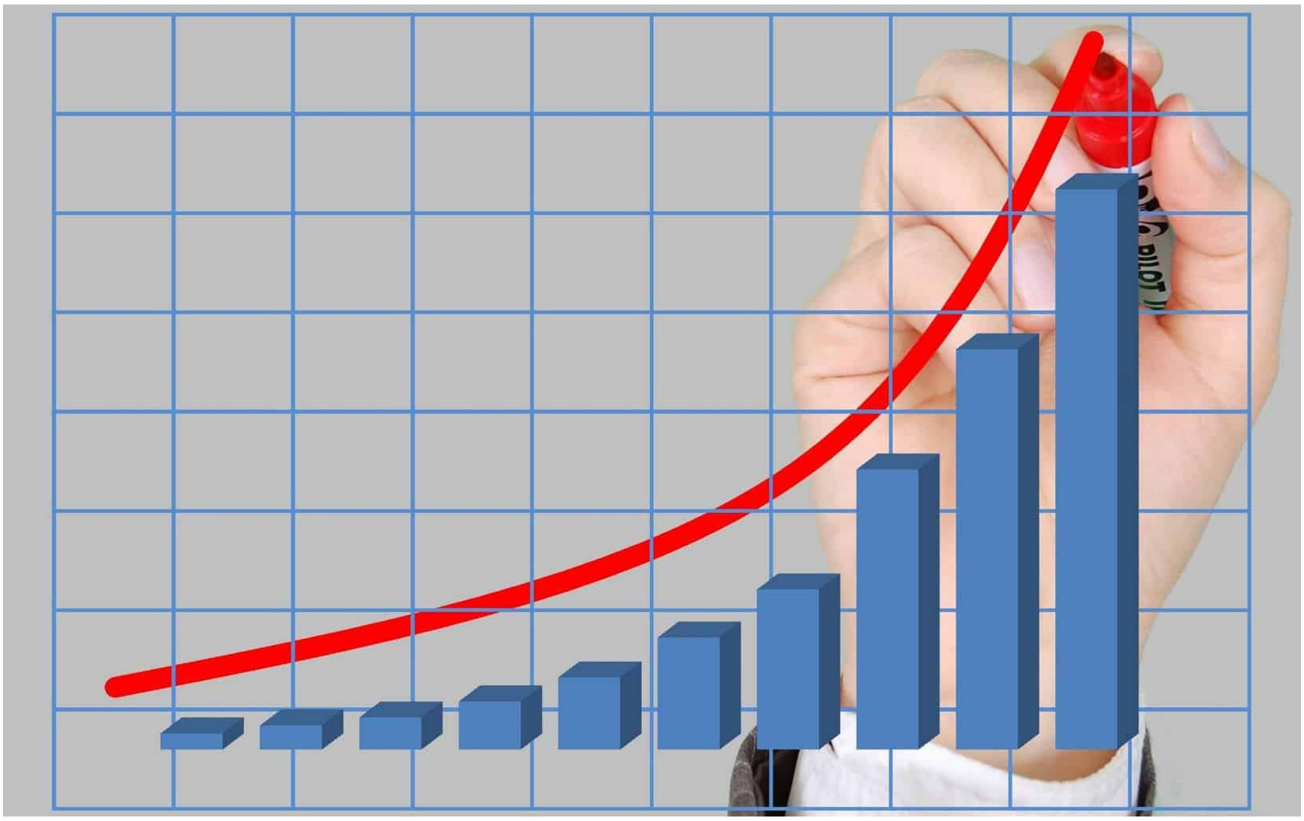
Between 2019 and 2021, *the gap between India and China has grown even bigger* and that is a fact that needs to be kept in mind. All numbers and figures need some context, otherwise they are useless and as good as propaganda, which I think will happen quite a lot during the course of the day today.

If you have already read the newspapers and the websites on this issue, you might have seen that almost all of them say that India will grow faster than China in 2021. But almost  no one bothers to mention the fact that China grew faster than India both in 2019 and 2020. Or the fact that China is growing on a significantly larger base (the most important point when we are talking percentages).

At the risk of repetition, you won't see any such analysis appearing in the mainstream media. So, kindly continue supporting my work. Even small amounts make a huge difference.

21 January, 2021

# [email protected] ,000 points and Some Basic 5th Standard Maths That Some Journalists Still Need to Learn



Early morning today, the BSE Sensex, India's most popular stock market index crossed 50,000 points during intra day trading.

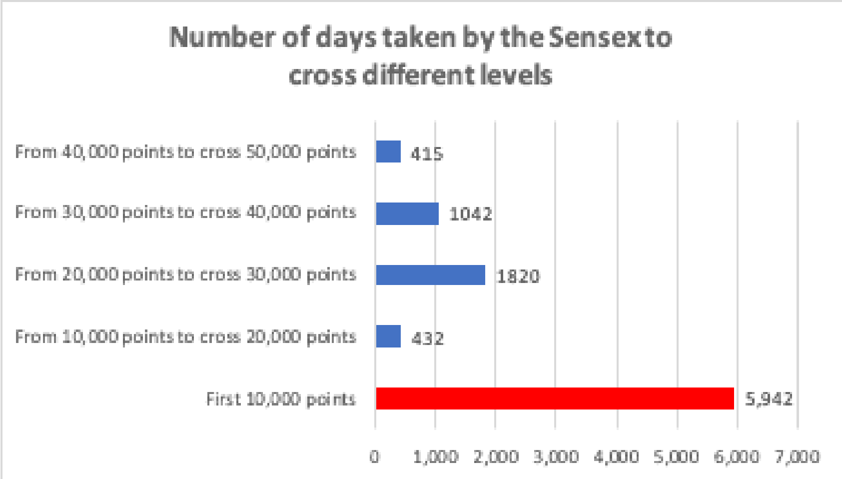
Not surprisingly, this led to the bubbly being opened on the social media and business TV. These are celebrations which will be carried into the newspapers appearing tomorrow morning. This is hardly surprising given that every time the Sensex has crossed one of these major landmarks, the media has gone crazy celebrating it.

And I don't have a problem with it, given that the media is in the business of cashing in on good sentiment or to put it more precisely, creating good sentiment and then cashing in on it. The days of what bleeds that leads, are long gone.

One of the ways of celebrating is through graphics and data. One such graphic was shared by the Twitter handle of Business Today . It basically plots the number of days the Sensex has taken over the years to move 10,000 points in the upward direction.

Hence, it plots the number of days, the Sensex took to cross the first 10,000 points, then move from 10,000 points to cross 20,000 points and so on, and finally, to move from 40,000 points to cross 50,000 points.

This is how it looks like.




Looking at the above chart, Business Today concludes that the Sensex moving from 40,000 points to crossing 50,000 points has been the fastest, as it has happened in just 415 days. This, as we can see, is the least number of days. The next fastest was between 10,000 points and crossing 20,000 points, which took 432 days, which is seventeen days more.

Yay, and that is a cause for huge celebration. Okay, Business Today, didn't say that, I added it.

During the course of my nearly 18 years of writing for the business media, I have seen a lot of stupid charts and data being used to make a point, but this takes the cake.

Why? Simply because it doesn't take fifth standard percentages into account.

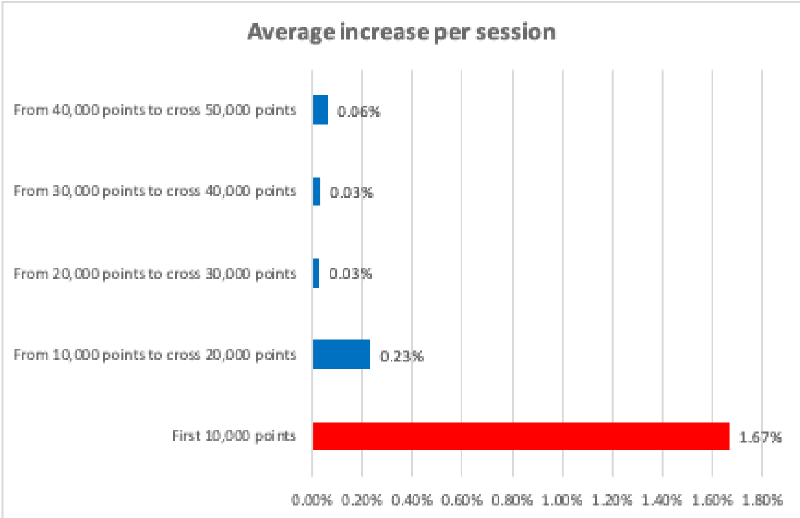
The BSE Sensex is an index. Every index has a base value. The base value of the BSE Sensex is 100. So, when the BSE Sensex first rose from 100 points to 10,000 points in 5,942 days, it meant a rise of 9,900 points or 99 times the original value of 100 or 9900%.

In comparison, the rise between 40,000 points and 50,000 points is just 25%. So, what are we really comparing? Who are the editors clearing such graphics? Why are people being misled on such simple data points?

The question is how do we analyse this properly. The right way to do this is look at the average jump in percentage terms per trading session, in each bracket. So how do we calculate this? The Sensex moved up 9,900% in 5,942 sessions, when it crossed the first 10,000 points. Hence, it moved around 1.67% per trading session on an average (9,900% divided by 5,942 trading sessions) **,** during the period .

Further, the Sensex moved 25% in 415 sessions, when it moved from 40,000 points to cross 50,000 points. Hence, it moved 0.06% on average per trading day (25% divided by 415 trading sessions), during the period. So, the movement of the Sensex between 40,000 points to crossing 50,000 points has been much slower than crossing the first 10,000 points.

Here is how the proper chart looks like.

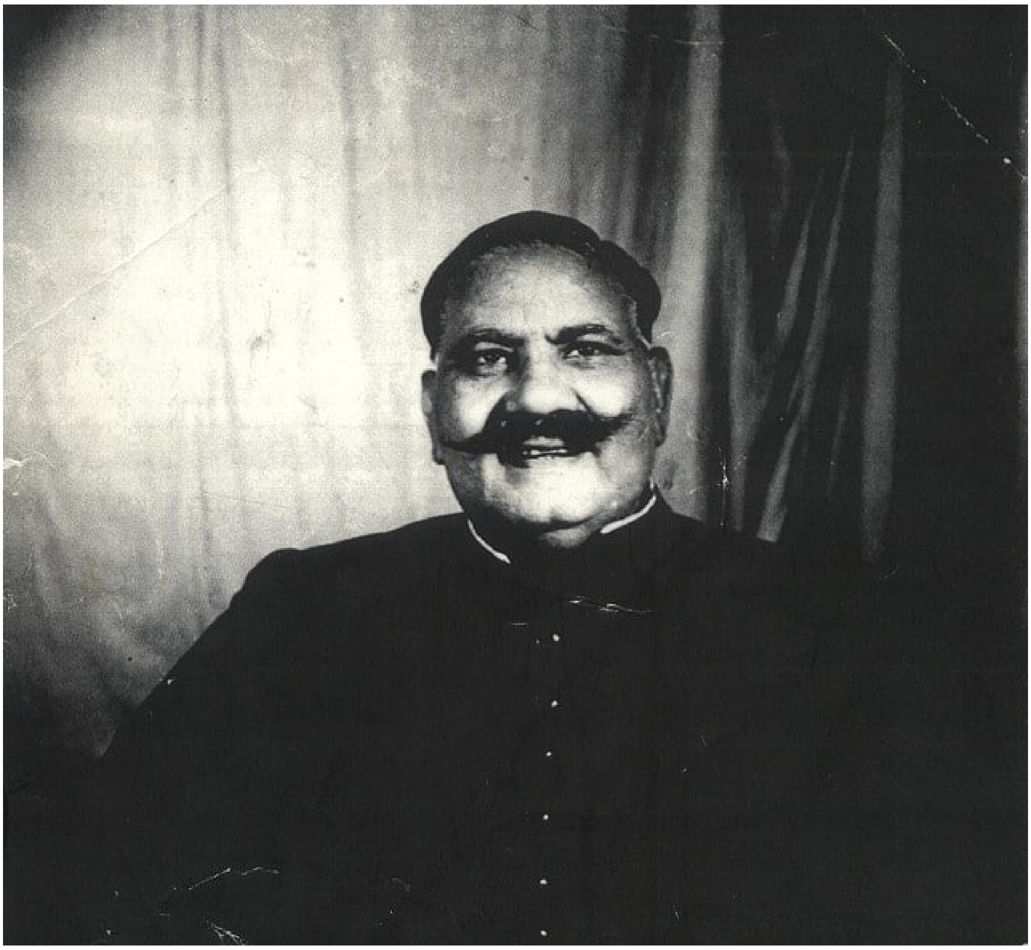



What does this tell us? It tells us that the first 10,000 points were achieved the fastest. This was followed by the movement between 10,000 points and 20,000 points, where the average gain was 0.23% per trading session. The movement between 40,000 points and 50,000 points at 0.06% per trading session comes third.

Sorry for belabouring on this rather basic point but I get really irritated when people use mathematics and data to mislead, sometimes not even knowing that they are misleading.

20 January, 2021

# On Test Cricket



*— Bade Ghulam Ali Khan.*

It's the morning after.

Yesterday, the Indian cricket team managed to pull off its most famous Test match win ever, the recency effect of it notwithstanding. In the truest sense of the term, it was a fine *Ocean 11* 's kind of heist which went right down to the wire, and not the tacky *Dhoom* type.

The sun is just about getting ready to peep out of the clouds. While a whole host of things remain to be done, I am reluctant to start my workday given that I am still brimming with excitement over yesterday's win.

And in this situation who wants to write yet another piece on what the government should do in the next budget. (For those who don't know me, I make a living out of writing on economics and finance).

As I process yesterday's win and get ready for the boring, mundane day that lies ahead, Ustad Bade Ghulam Ali Khan is singing his legendary thumri *ka karun sajni aaye na balam.* It took me years to reach a level where I could appreciate the brilliance of Khan sahab's singing.

My interest in music started with listening to Hindi film music on Vividh Bharti. Over the years, thanks to my father and a few neighbours, I graduated to listening to Jagjit Singh sing *ye kagaz ki kashti ye baarish ka paani.*

And then it was Ghulam Ali singing *faasle aise bhi honge ye kabhi socha na tha.*

It continued with Mehdi Hasan singing *ranjish hi sahi dil hi dukhane ke liye aa.*

And I thought I had reached the peak of listening prowess when I heard Akhtari Bai Faizabadi sing *wo jo humme tumme karar tha, tumhe yaad ho ke na yaad ho.*

The greatness of these singers notwithstanding, everything fell flat once I had heard Ustad Bade Ghulam Ali Khan sing *ka karun sajni aaye na balam.* Of course I am mixing genres of music here, but that's the way it is and I can't do anything about it.

So what's the point here? It took me years of listening to music patiently and spending all the time that I did, to reach a stage where I could appreciate Khan sahab's singing. It didn't happen in a day or even a year or two, it took decades.

Imagine what would have happened, if someone had introduced me to Khan sahab's singing in the 1990s. I would possibly have turned around and said what rubbish is this. It's so slow. And he sings the same thing over and over again. Have you heard Kumar Sanu sing *maine pyar tumhi se kiya hai, maine dil bhi tumhi ko diya hai* ?

But then I was still maturing as a listener. Appreciating good things in life takes time. It takes decades to develop some taste, if at all that happens.

The question is, why have I been going on and on about Bade Ghulam Ali Khan sahab in a piece supposedly on Test cricket. Let me explain.

Watching Test cricket for me is an experience similar to listening to Khan sahab sing *ka karun sajni aaye na balam* . I wasn't always up for it.

My first memory of watching cricket goes back to India winning the World Championship of Cricket in 1985. Doordarshan had just come to Ranchi, the city I was born and brought up in, only a few months earlier on October 2, 1984, and we had bought our first TV on December 25, 1984 (It was an Uptron).

I don't have many memories of the 1987 Reliance World Cup other than India losing the semi-final to England in Mumbai. For days at end there were rumours of Dilip Vengsarkar having opted out of playing in the semi-final because Sunil Gavaskar wanted India to lose, since he didn't want to play the final scheduled in Kolkata (then Calcutta).

The 1992 Benson and Hedges World Cup was the first cricket World Cup I saw in colour and on cable TV. My memories of it are limited to India losing to Australia by one run, thanks to a stupid rain rule, which would eventually *also* cost South Africa a place in the finals. I still remember the looks on the face of Brian McMillan and Dave Richardson, the South African batsman at the crease, when the rain rule revised South Africa's target to 22 runs to get from one ball.

The 1996 World Cup was when things got really personal. We were not supposed to lose.  But then despite the bowling heroics of Javagal Srinath who got rid of both Sanath Jayasuria and Romesh  Kaluwitharana very quickly, Sri Lanka went on to win the semi-final, once the pitch started spinning like a top during the Indian innings and our batting simply collapsed after Sachin Tendulkar got out, as was often the case in those days.

My final memory of that lousy day is that of Vinod Kambli slowly walking off the Eden Gardens with tears in his eyes, once the match referee Clive Llyod decided to call off the match and award a victory to Sri Lanka, due to crowd trouble.

The pain that followed was very personal. After the game got over, I walked around aimlessly for at least two hours in the colony we used to live in, trying to process what had just happened. It simply didn't make any sense. How could India lose?

After that loss, over the years, things became less personal when it came to cricket. The main reason for it was the rise of cable TV and the fact that the live cricket broadcast became more and more ubiquitous. The popularity of cable TV and ODI cricket went hand in hand, with each feeding in on the other.

The law of diminishing marginal utility was also at work and the continuous live coverage of cricket, made it like just another game, you watched, you forgot and you moved on. The value of the game wasn't quite the same. As the supply of cricket increased, the enjoyment with each extra game being played, came down.

In fact, the rise of T20 cricket led to my emotions getting totally detached from the game. My mother used to watch soap operas while having dinner (now she watches Netflix), and I watch IPL, when it is on. These days I watch the Aussie Big Bash League while having lunch.

Cricket, like soap operas for my mother, became another time filler for me.

Then things started to change in 2012, when I quit my full-time journalism job and went freelance. This is when I seriously started watching Test cricket because I finally had the time to watch a game which unfolds itself leisurely over a period of five days. Until then I used to follow Test cricket but post 2012, I started seriously watching it.

And like I took time to appreciate the singing of Bade Ghulam Ali Khan sahab, it took me time to appreciate Test cricket, and when I did, boy did I enjoy it. I had go through watching a lot of 50 over cricket, international T-20 cricket, league T-20 cricket and first class matches, to finally start appreciating Test cricket. It was a proper process.

Much of T-20 cricket to me is *timepass* and to put it honestly, given a choice, I would rather spend time eating the original Indian timepass, the humble *moongphali,* than watch T-20 cricket.

A simple reason why I find Test cricket more enjoyable is because the game is much more balanced, with the bowlers getting almost an equal chance as batsmen.

Like it is in ODI cricket, the quota of overs a bowler can bowl is not limited. This means the best bowlers in a team can keep bowling as long as their body allows them to. Among the Aussie fast bowlers, Pat Cummins bowled the most overs in the fourth innings at Brisbane. Not surprisingly, he is the world's number one rated fast bowler. And his bowling made the game as enjoyable as the Indian batting.

What also helps is the fact that in Test matches, the pitches, drop-in or otherwise, are a little more bowler friendly, unlike ODI matches where some of the pitches are like Mumbai's cemented Marine Drive or even more aptly the Khan Abdul Ghaffar Khan Road, which is better known as the Worli Seaface and where I ideated a bulk of this piece.

Second, there are no limits to the way a captain can place his fielders. He is free to place all his fielders on the boundary line, if a batsman is going crash, boom and bang. Fielding restrictions make many a modern day batsman look so much more better than he actually is.

Oh and in Test cricket boundaries are not brought in, or at least not as much as they are in 50 over and 20 over cricket, where many a mishit by batsmen goes for a six. Hence, finger spinners have a better chance in Test cricket.

And finally, I love the slowness with which the game unfolds and builds pace. On a good day, watching Test cricket is like reading a great Scandinavian police procedural where things unfold at a leisurely pace, the story builds up and then it climaxes with every random bit coming together.

Like yesterday's Test match, if Cheteshwar Pujara hadn't taken all the blows and tired out the Aussie bowlers, they wouldn't be bowling the lollypops they did later in the day, in particular Mitchell Starc. Imagine, Josh Hazelwood finally bowled a full toss which Rishabh Pant straight drove for four and India won the game.

And before that, if Washington Sundar and Shardul Thakur hadn't put on the 123 runs they did, there would have been no chance of the world watching the heroics of Shubman Gill and Pant.

Of course, all this needs time and the mental energy to constantly follow the game over five days or the time that it lasts, and rise and fall with its ups and downs. How do you do that while holding on to a proper job? How do you invest your emotions in cricket 100%?

One reason why the recent India-Australia series has been so closely followed is because most people are still working from home and given that there is always an opportunity to switch on the TV and watch the game, while pretending to work. I am really not sure if the series would have been as exciting as it has turned out to be, if covid hadn't forced people to work from home. Test cricket, unlike ODI cricket, needs a lot of attention. And attention and being at office don't always go together.

All this comes from a true blue Indian Test cricket fan. I don't watch tennis simply because no Indian really plays the singles game well enough. I don't watch football either because I find it hypocritical, living on Linking Road in Mumbai and supporting Liverpool or living in Malleswaram in Bengaluru and going gaga over Manchester United.

In the end, the India Australia Test series has led to a lot of talk about the revival of Test cricket. But that is not going to happen simply because people don't have the time. The rat race, even though at the end of it you are still a rat, is more important, and why shouldn't it be.

So that still leaves me with the memories and memories are all I have. And as Pant hit the winning boundary, which I later realised Sanjay Manjrekar on air thought was just a single run, Bade Ghulam Ali Khan sahab was still singing *ka karun sajni aaye na balam.*

Test cricket and Khan sahab where both on a loop!

19 January, 2021

# 10 Things You Need to Know About Indian Real Estate in 2021

If you are the kind who follows the business media closely, you would probably be thinking that for the last few months all people have done across India is buy homes to live in. But is that really true? The short answer is no, though sales did pick up during October to December 2020, in comparison to the three month period before that. But whether that was pent up demand or genuine demand coming back, only time will tell.

A thriving real estate sector really helps the overall economy grow at a fast pace. But given the mess that the Indian real estate sector has been in for many years, and the fact that *the deep state of Indian real estate* won't allow market forces to work to help clean it up, that isn't really going to happen.

Let's look at the issue in more detail.

**1)** As per the annual roundup of residential real estate published by PropTiger Research, sales in 2020 contracted by 47% to 1.83 lakhs across eight large cities (Delhi NCR, Mumbai, Pune, Ahmedabad, Chennai, Bengaluru, Hyderabad, Kolkata).

In short, 2020 was a bad year for real estate. Having said that, sales during October to December 2020 picked up and 58,914 units were sold, which was 68% more in comparison to the number of units sold during July to

September 2020. In comparison to October to December 2019, sales were down 27%, during the period.

Of course, the real estate sector wants us to believe that demand is back and all is well with the sector. Nevertheless, this jump in sales can be because of pent up demand. Whether it sustains in the months to come remains to be seen. This is an important caveat to keep in mind.

**2)** More than half of these sales have happened in Mumbai and Pune. The reason offered for this is the cut in stamp duty carried out by the state government. The Maharashtra government cut the stamp duty applicable on real estate transactions from 5% to 2%. This was applicable until December 31, 2020.

The stamp duty cut driving up builder sales, is true to some extent. Given that the price of an apartment in a city like Mumbai runs into crores, even a 3% saving on the price runs into a decent amount of money. But more than the stamp duty cut, a *substantial* drop in prices, especially for homes priced at more than Rs 2 crore, is the main reason for the sales in the city picking up.

Independent real estate expert Vishal Bhargava has pointed this out in the past in his columns (Those who like to follow Mumbai's real estate scene, should seriously read all that Vishal writes ).

Of course, you haven't read about this in the mainstream media simply because the mainstream media depends on advertisements from real estate companies and needs to keep driving the notion that real estate prices don't fall, over and over again. (Another reason you need to support my work ).

One reason for a fall in prices is the fact that businessmen who run small and medium enterprises have been facing a tough time since covid broke out. And they are looking at alternate avenues to raise money to keep their businesses going. This includes selling the real estate assets they have accumulated in the past. There is some distress sale as well.

Also, other than Mumbai and Pune, the other six cities account for less than half the sales. This tells us clearly that real estate sales in these cities are at best sluggish.

**3)** The clearest trend in the PropTiger data is that 48% of the sales have been for apartments selling at a price of less than Rs 45 lakh. What this tells us is that high prices remain the biggest challenge of owning a home in India. It also tells us that while home prices haven't really fallen, on the whole across India, despite the lower demand, the demand that remains is primarily at the lower end of the price spectrum. Hence, the market has corrected itself in its own way, despite home prices not coming down in absolute terms. This is an important lesson that the real estate industry needs to learn.

Also, 74% of the sales have happened for home prices of less than Rs 75 lakh.

**4)** As far as prices are concerned, the PropTiger report points out: "Weighted average prices for new launched projects across the top-eight cities remained stagnant in the past few quarters, with prices moving in close ranges."

This is something that is also reflected in Reserve Bank of India's 10 city house index, though the cities tracked by this index are not the same as the cities tracked by PropTiger.


**Source: Centre for Monitoring Indian Economy.**

The cities tracked by the RBI's 10-city house index are Mumbai, Delhi, Chennai, Kolkata, Bengaluru, Ahmedabad, Lucknow, Kanpur, Jaipur and Kochi. The index tells us that the average one-year return of owning real estate in India during the period July to September 2020, stood at 1.13%. This is the lowest since the index came into existence. The index also tells us that the return on real estate during 2020 has been marginally negative.

What this means is, and as I have often said in the past, Indian real estate is going through a time correction and not a price correction. The inflation seen over the last two years has been around 6% per year on an average. This means in real terms, the prices have already corrected by more than 12%, over a two year period.

**5)** This trend is likely to continue given the huge amount of inventory that remains piled up with builders. The overall inventory stock is at 7.18 lakh units across eight cities as per PropTiger. It has come down from 7.91 lakh units in 2019, simply because builders aren't launching as many new projects as they used to.

Having said that, with the sales slowing down, at the current sales pace it will take around 47 months to clear the remaining inventory. Even though all this inventory is not ready to move in, a significant portion is. Also, it is worth remembering that the prospective buyers have a choice when it comes to buying a home. Over the years, investors across the country have ended up buying a huge number of homes in the hope of a price appreciation. Many of these homes have remained locked and are available for sale.

As Bhargava wrote in a recent column : "Resale transactions are traditionally 2/3 rd of the market." Even if this proportion were to come down, resale transactions of locked homes will continue to form a significant chunk of the market, making it difficult for builders to cut down their inventory quickly. Also, even if builders don't offer ready to move in homes, there is a significant supply that will keep coming in from individuals who have bought real estate as an investment over the years.

**6)** Homes priced below Rs 45 lakh form 48% of the inventory. What does this tell us? It tells us that the real demand for homes is at a price even below Rs 45 lakh, probably below Rs 25 lakh. This is something that the builders need to keep in mind. It may not work in a city like Mumbai, where land available is limited and expensive, but it will definitely work for the other seven cities that PropTiger tracks and other parts of India, where cities can expand in all directions and land is really not an issue.

**7)** It is worth remembering here that builders have benefitted because of the Reserve Bank of India allowing banks and non-banking finance companies, to restructure commercial real estate loans.

As former RBI governor Urjit Patel writes in Overdraft—Saving the Indian Saver :

> *"In February 2020, 'living dead' borrowers in the commercial real-estate sector – under a familiar guise ('a ghost from the past', if you will) viz., ad hoc 'restructuring' – have been given a lifeline. It is estimated that over one-third of loans to builders are under moratorium."*

Patel does know a thing or two about banks and lending and hence, needs to be taken seriously. It remains to be seen for how long will the RBI continue supporting the builders. The longer, the RBI supports the builders, the longer they can hold on to a *significant* price cut. This also means that inventory will take longer to clear and home prices will continue to stagnate. It is all linked.

**8)** At a macro level this means that the ability of real estate to create jobs for the unskilled and the semi-skilled, will continue to remain limited. It is also worth remembering that real estate as a sector can have a huge multiplier effect on the overall economy.

The real estate sector has forward and backward linkages with 250 ancillary industries. This basically means that when the real estate sector does well, many other sectors, right from steel and cement to furnishings, paints, etc., do well.

If this were to happen, the Indian economy would really benefit in the post-covid times. But sadly it won't, given that the deep state of Indian real estate which includes, builders, banks and politicians, will make sure that the sector is continued to be treated with kids gloves and any problems which could lead to a price cut, are kicked down the road. Trying to maintain the *status quo in the sector* is not helping the Indian economy.

**9)** Dear reader, some of you by now must be like all this *gyan* is fine, but tell me one simple thing, should I buy home or should I hold on to my money. The answer as always is, *it depends* . It is worth remembering here, that what we can possibly do with our money is a very individual thing.

If you are looking to buy a home to live in and have the capacity to pay an EMI and arrange for a down-payment, then this is a good time as any to buy a home. Owning a house has its own set of advantages. Parents and in-laws feel you have settled in life. There is no danger of the landlord acting cranky. And once you have children it gives them some kind of stability with friends, activities as well as the school they go to. Of course, address proofs don't need to change, every time you move house.

Having said that do keep in mind that we live in tough times and the negative economic impact of covid is yet to go away. Also, there can be further cycles of the spread of the virus. Before taking on a home loan, ensure that you have some money in the bank to be able to continue paying the EMI in case you lose your source of income.

When it comes to investing in a house, it continues to remain a bad idea on the whole. Of course, there will always be some good opportunities and some distress sales happening.

**10)** Finally, everyone who makes a living out of selling real estate will spend 2021 trying to tell us that demand is coming back, people are buying homes, new trends are springing up and all is well.

As PropTiger points out:

> *"By making bare the limitations involved in other investment assets, the pandemic has forced people to rethink their investment strategies, tilting it in favour of home ownership."*

This is *basically rubbish* which has been written well. Why would anyone in their right mind during tough economic times, invest a large part of their savings and/or take on a large loan to buy an illiquid asset?

Some people who can afford it, may have definitely bought new homes in order to adjust to the new reality of work from home, but beyond that the proposition that PropTiger is making, remains a difficult one to buy.

If it were true, some of the massive amount of easy money that is currently floating around in the financial system, would have gone into real estate as well. But given that sales have crashed 47% during 2020 tells us that it clearly hasn't.

In fact, the outstanding home loans of banks between March 2020 and November 2020 have gone up by *just* Rs 44,463 crore. This is around two-fifths of the increase (38.7% to be precise) in outstanding home loans of Rs 1,14,636 crore seen between March 2019 and November 2019. This is despite the fact that home loan interest rates have come down to as low as 7%.

So, people are generally being careful when it comes to buying a home by taking on a loan and that is the right strategy to follow at this point of time.

17 January, 2021

# [email protected] ,000 – How RBI Played a Part in Creating the Stock Market Bubble

The BSE Sensex, India's premier stock market index, crossed 50,000 points today in intra day trading. It has risen by more than 80% from around the end of March, when it had fallen to 27,591 points, in the aftermath of the covid pandemic hitting India.

This astonishing rise has now got the Reserve Bank of India (RBI) worried. The RBI Governor Shaktikanta Das, writing in the foreword to the latest Financial Stability Report, pointed out:

> *"The disconnect between certain segments of financial markets and the real economy has been accentuating in recent times, both globally and in India."*

People who run central banks are not always known to talk in simple English. Das is only following tradition here. The statement basically refers to stock prices. Das feels they have risen too fast in the recent past and have become disconnected from the overall economy.

While the overall Indian economy is expected to contract this year, the stock market has rallied by more than

80%. How is this possible? Or as you often get to hear these days, if the economy is doing badly, why is the stock market doing so well.

Theoretically, a possible explanation is that the stock market discounts the future and the stock market investors think that the future of the Indian economy is bright. Another explanation offered often by the stock market investors is that corporate profits this year have been at never seen before levels.

But even after taking these reasons into account, the current high level is really not justified. As Das put it in his foreword: “Stretched valuations of financial assets pose risks to financial stability.” One way to figure out whether valuations are stretched is to look at the price to earnings ratio of the stocks that constitute the Sensex index.

In January 2021, the price to earnings ratio has been at around 34. This means that investors are ready to pay Rs 34 as price, for every rupee of earning of the companies that make up for the Sensex. Such a high level of the price to earnings ratio has never been seen before. Not even in late 2007 and early 2008, when stock prices rallied big time or the first half of 2000, when the dotcom bubble was on.

Clearly, stock prices are in extremely bubbly territory. The current jump in corporate earnings isn’t sustainable for the simple reason that corporates have pushed up earnings by cutting employee costs as well as raw material costs. This means the incomes of those dealing with corporates from employees to suppliers and contractors, have fallen.

This fall in income has limited the ability of these individuals to spend money. This will lead to lower private consumption in the months to come, which, in turn, will impact corporate revenues and eventually profits. A sustainable increase in profits can only happen when people keep buying things and corporate revenues keep going up.

This brings us back to the question as to why stock prices are going up, when the overall economy is not doing well. A part of the reason is the RBI, though the central bank, rather expectedly, glosses over this totally in the latest edition of the Financial Stability Report.

Since February 2020, the RBI has pumped in a massive amount of money into the financial system through various measures, some of which involve the printing of money. By flooding the financial system with money, or what central banks refer to as liquidity, the RBI has ensured that interest rates in general and bank deposits in particular, have fallen.

The idea here is threefold. A drop in interest rates allows the government to borrow at lower interest rates. This became necessary because thanks to the pandemic, the tax collections of the government have dropped during this financial year. Between April and November 2020, the gross tax revenue stood at Rs 10.26 lakh crore, a drop of 12.6% in comparison to the same period in 2019.

Secondly, lower interest rates ensured that the interest costs of corporates on their outstanding loans, came down. Also, the hope was that at lower interest rates, corporates will borrow and expand.

Thirdly, at lower interest rates, the hope always is that people will borrow and spend more, and all these factors will lead to a faster economic recovery.

But there is a flip side to all this as well. A fall in interest rates has got people looking for a higher return. This has led to many individuals buying stocks, in the hope of a higher return and thus driving up prices to astonishingly high levels.

This can be gauged from the fact that in 2020, the number of demat accounts, which are necessary to buy and sell stocks, went up by nearly a fourth to 4.86 crore accounts. One of the reasons for this is the rise of Robinhood investing in India. This term comes from the American stock brokerage firm Robinhood which offers free online trading in stocks. India has seen the rise of similar stock brokerages offering free trading.

What has added to this is the fact that many unemployed individuals have turned to stock trading to make a quick buck. All it needs is a smartphone, a cheap internet connection and a low-cost brokerage account.

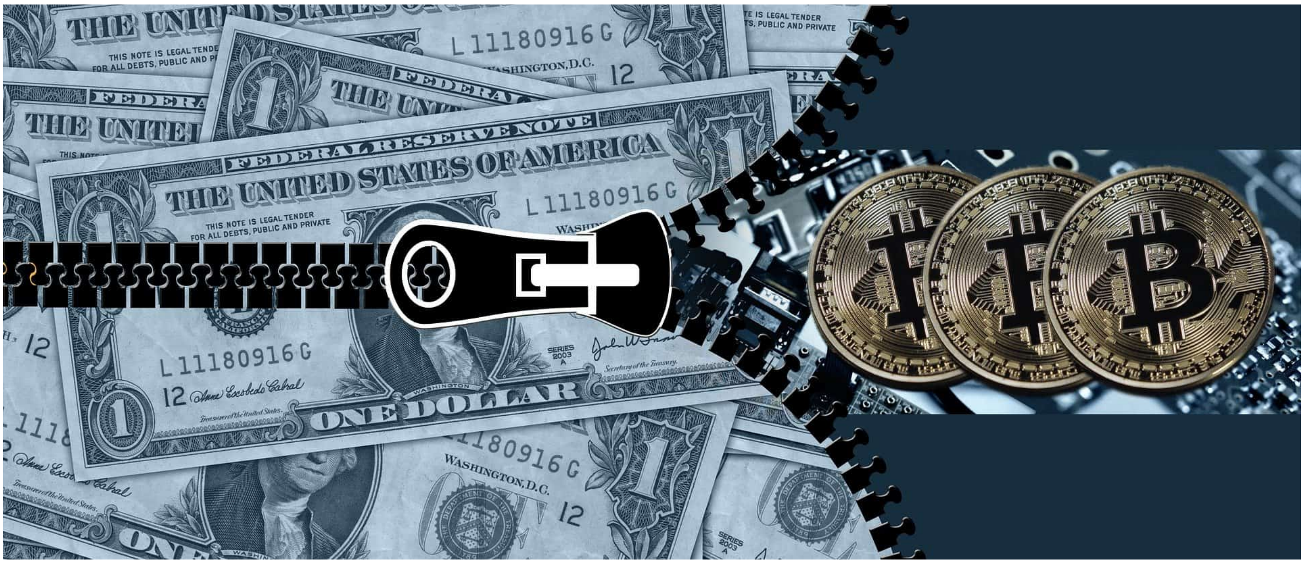
Of course, this search for a higher return isn't local, it's global. Hence, foreign institutional investors have invested a whopping $31.6 billion in Indian stocks during this financial year, the highest ever. This stems from the fact that Western central banks, like the RBI, have printed a huge amount of money to drive down interest rates.

This has pushed more and more investors into buying stocks despite the fact that the global economy isn't doing well either.

A slightly different version of this column appeared in the Deccan Herald on January 17, 2021. It was updated after the Sensex first crossed 50,000 points during intra day trading on January 21, 2021.

16 January, 2021

# An Open Letter to Bitcoin Bhakts




*Vo intizār thā jis kā ye vo sahar to nahīñ*
— Faiz Ahmed Faiz.

A couple of days back I wrote a long piece on bitcoin . As expected the backlash was huge, though a couple of people did engage very nicely and in a fact-driven way (You know who you are, so, thanks a tonne for that).

But a bulk of the response from the *bitcoin believers* was like *we know everything about bitcoin and this guy doesn't know what he is talking about.* Of course, they didn't say this in as polite a way as I am putting it here (or as one believer put it, it was 5,100 words of *potty* ).

In this piece I wanted to list out a random list of points which I have been thinking about over the last couple of days since I published the bitcoin piece. Some of these points have got to do with investing in general and some with bitcoin in particular. Of course, there are points about the *bhakts* , the bitcoin bhakts, as well.

The conclusion at the end of this piece is the same as the last bitcoin piece, which is that, the life of bitcoin started with an ambition to become a cryptocurrency which wanted to replace the global paper money system. But it has ended up becoming an object of pure speculation and nothing else. (I can already see the bitcoin bhakts going: good you have mentioned this upfront, we don't need to read beyond this. Our beliefs are safe).

So, here we go.

**1)** I had been postponing writing the bitcoin piece for a while now. This was probably my way of coping with the backlash I was expecting once the piece was published. But I am glad that I wrote it. What it told me was that bitcoin bhakts like bhakts in general and investing bhakts in particular, are a *petulant* lot. You don't agree with them and they are ready to get you.

In a way it's like *god, religion and parents* . My god is the best. My religion is the best. My daddy is the strongest. My mother is the sweetest. And my bitcoin is the best. And if you don't agree with me then you don't know anything and you are going to get it from me.

**2)** A very strong unwavering belief hurts when it comes to investing. I have now spent nearly two decades, starting in 2002, writing about business, economics, finance and investing. And I have seen this sort of behaviour before. When I first started writing about a bubble in real estate, sometime in 2013, I got a similar response from real estate investors all over India, like I have from the bitcoin believers, over the past two days.

Real estate prices in 2013 had been rallying for more than a decade and *almost* no one was ready to believe at that point of time that they could fall or stagnate for a long period of time. Many didn't even believe there was a bubble.

In fact, many people still don't, holding on to their investment in the belief that the happy days of pre 2013 will be back. (Now only if these people knew how to calculate the internal rate of return on any investment, which they clearly don't). Of course, the reason for holding on to real estate can always be an emotional one as well.

So, yes, the bitcoin bhakts aren't the first believers. There have been believers before them and there will be believers after them. This time is no different.

**3)** One response that came over and over again was that this guy (that is me) has no idea what central banks have been up to over the years. They have printed so much money, you know. *What is he even talking about.*

Well, to set the record straight, anyone who has followed my writing over the years would know the number of times I have written about money printing and central banks and how it is a bad idea. I have also written three books on this issue . I mean I have almost made a career out of it.

But the more important point here is that just because central banks have been printing money doesn't mean that the paper money system is going to come to an end quickly and bitcoin will takeover. This is a great example of lazy thinking, and the fact that the human mind is not built to think through complex multi-dimensional issues. This is bounded rationality at work and the bitcoin bhakts have also become a victim to that.

We all need reasons for doing something and more often than not the reasons are very simplistic. Like the case here. Bitcoin will take over the world because central banks have been printing money and now that I have bought bitcoin I need to firmly believe in this. Really

As I explained in my previous bitcoin piece there is a huge status quo which is a powerful force and which benefits from the paper money system in its present form and they aren't just waiting there to rollover, once the bitcoin bhakts come attacking.

The paper money system that bitcoin bhakts keep talking about has the American dollar at the heart of it. The world trade happens largely in dollars, giving the United States an enormous exorbitant privilege. While every other country in the world needs to earn dollars, the US can simply print it.

And given this, this is a privilege the United States isn't really going to let go in a hurry. *Why do you think US consumption is around a fourth of the global economy, while the country has only 5% of the world's population?* Which US politician in his or her right mind, is not going to worry about this dynamic?

Yesterday, someone on Twitter, shared a news-item which said that an American Senator was in favour of bitcoin as money. I am sure random American Congressmen support random things. Take the case of former Congressman Ron Paul, who supported gold as money for years on end. That does not mean that the American financial system will move to gold as money. So, we are talking change at a systemic level here, not some random guy supporting some random thing, please understand that.

**4)** I was also told repeatedly that bitcoin is an anonymised peer to peer network and I was making the mistake of looking at it as a centralised system. Well, that is really rich coming from guys who are *buying bitcoin from brokers* and giving away all their identity details. The moment you are doing that you are buying a speculative asset and not a future form of anonymised money.

**5)** When I said that barely anyone accepts bitcoin as a payment, two people wrote to me to say that they did. This is precisely the point I was trying to make. They were the exception that proves the rule.

In fact, as the American journalist James Surowiecki wrote in a recent post on bitcoin : "The blockchain analysis company Chainalysis, for instance, found that in the first four months of 2019, just 1.3% of total transactions involved merchants."  A bulk of bitcoin payments were used to pay for illicit goods and services like drugs and online gambling. (This is not to say that paper money isn't used for these things. It is. But then the bulk of payments are for regular everyday transactions).

Also, even with these payments, bitcoin payments form an insignificant part of the overall whole. As Surowiecki writes: "On average, there are now around 325,000 Bitcoin transactions — including trades — per day. There are roughly a billion credit card transactions per day." Over and above this, there are debit card transactions, cash transactions and digital money transactions, to consider. Bitcoin is nowhere in all this.

This is primarily because the bitcoin system is very slow to process transactions. It can process seven transactions a second. Visa, on the other hand, processes 6,000 transactions a second.

I can go on and on why bitcoin is not a medium of exchange, like a good form of money should be, but I will leave it at this.

**6)** The main reason why very few businesses accept bitcoin as payment is the volatility of its price, Surowiecki points out. Let's say a business takes payment in bitcoin. Chances are that the next morning the price falls majorly, then the business can end up with a loss on the transactions it made a day before. (Of course, the price can go up as well… but then this is business not gambling).

The volatility of price comes from the fact that most people buying bitcoin are in it, in order to make a quick buck. They see an asset whose price is going up, they buy it. When they see an asset whose price is going down, they sell out. Of course, there are believers as well.

**7)** This is an interesting one. I learnt yesterday that you identify a bitcoin bhakt, the moment he says HFSP to you. For all the Boomers out there, HFSP stands for *Have Fun Stay Poor* . Apparently, this is something that bitcoin bhakts say often when people question their core beliefs. It's an easy, slightly humorous way to get back without necessarily having to think through what the person questioning their core beliefs is basically trying to say. (It's all potty you know).

Also, it is important to understand, different people are mentally built differently, when it comes to how they look at money. In my scheme of things *return of capital is more important than return on capital* when it comes to money and investing. Money has never come easily to me and whatever I have I would rather protect it than take a punt with it. If that means staying poor in the eyes of bitcoin bhakts, then so be it.

But then that shouldn't stop you from buying bitcoin. If you feel it needs to be a part of your investment portfolio and if you feel that you are okay taking the risk, then please go ahead. It is your hard earned money at the end of the day.

**8)** The recent interest shown by hedge fund managers basically should tell everyone very clearly that bitcoin as an object of speculation is now entering the mainstream. Of course, this means that the price of the thinly traded bitcoin can go up even further. So, there might be more money to be made. But then do remember that hedge funds are a mercurial lot. They can go out of a trade much faster than they get into it.

Hence, the oldest cliché in investing, don't put all your eggs in one basket, applies to bitcoin as well. If you want to speculate, please go ahead and do it. But don't bet your life on it.

**9)** Many bitcoin bhakts believe in anarchy when it comes to the money system. They seem to be okay with different forms of cryptocurrencies competing with each other, a few dying in the process and the best ones continuing to exist.

It is important to understand here, that there is a difference between money and mobile phones. While mobile phone brands can keep changing, depending on customer preferences and specifications on offer, the same argument applied to money doesn't really work.

A major reason for the evolution of standardised fiat paper money lies in the fact that there were too many forms of money going around and this caused needless confusion and built huge costs of doing business into the system. A lot of this standardisation happened through the centuries and made lives easy for business and normal mortals. Of course, there are problems with this system.

**10)** I also understood something all over again. As the American novelist Upton Sinclair once remarked: " *It is difficult to get a man to understand something, when his salary depends on his not understanding it* ." When the price of an investment asset is going up at an extremely fast pace, all people can see is that it's going up, without realising that it's going up because it's going up.

To conclude, the life of bitcoin started with an ambition to become a cryptocurrency which wanted to replace the global paper money system. It has now become a speculative asset at best and nothing more.

As The Economist recently put it, rising prices of bitcoin "may be good news for those holding bitcoin that others are piling in, but speculators' enthusiasm suggests that cryptocurrencies will fall far short of their founders' lofty aspirations".

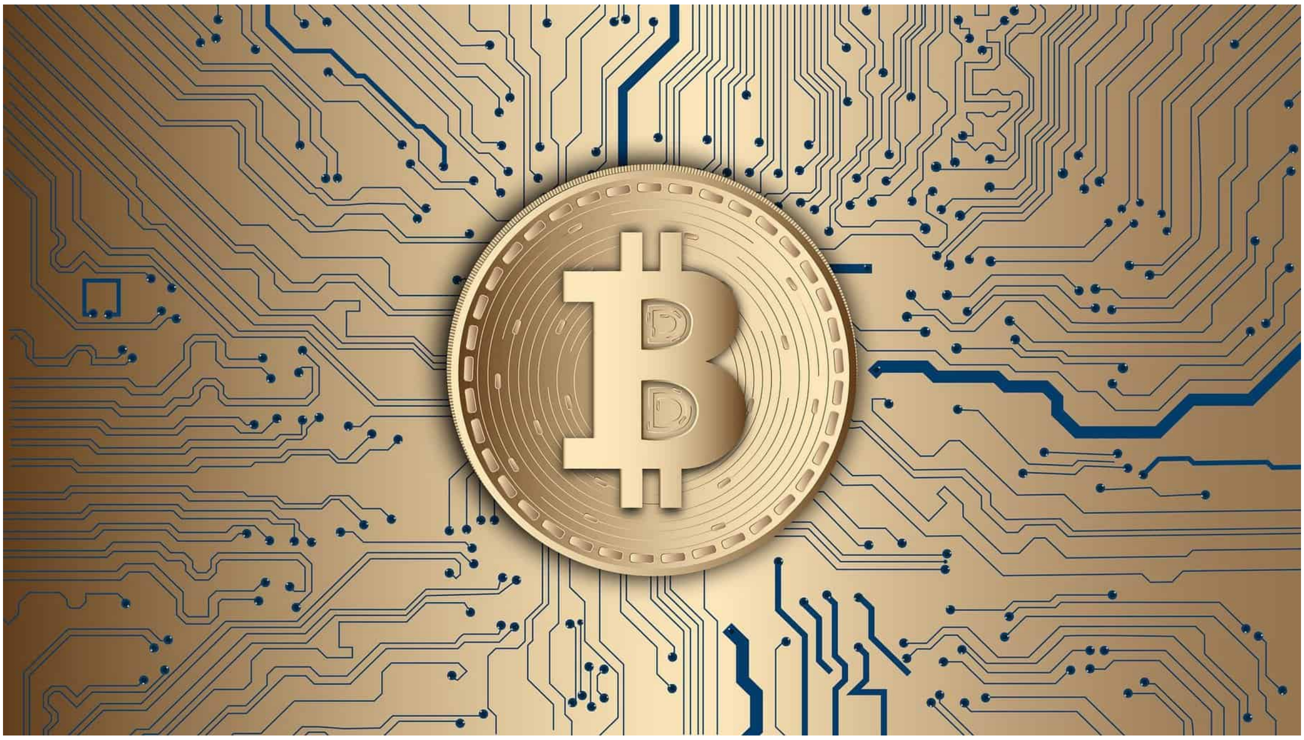
Satoshi Nakamoto, the mysterious inventor of bitcoin, whoever he is, wherever he is, must be a rich man today. Nevertheless, he must be a terribly disappointed man as well. This wasn't what he was trying to engineer.

The sad thing as always is, in life, things rarely go as planned.

*Kyon Dare Zindagi Mein Kya Hoga*
*Kuch Na Hoga To Tajruba Hoga.*
— Javed Akhtar.

14 January, 2021

# Bitcoin is a bubble, a way to speculate and not the future of money



*The actual writing of this piece took around six hours, though I have been thinking on this issue for at least the past nine years since I started writing my Easy Money book. I have been told that the backlash from the bitcoins believers will be huge. All feedback is welcome, as long as you don't abuse. And if you choose to abuse at least read the piece first. You will be able to abuse better.*

*Bulbulon ko abhi intezar karne do* . (Let the bubbles wait for now).
— Gulzar, Vishal Bhardwaj, Usha Uthup and Rekha Bhardwaj in *7 Khoon Maaf* .

Let's start this one with a small story.

Salvador Dalí was a famous painter who lived through much of the twentieth century. He was a pioneering figure in what is known as Surrealism.

Other than being a fantastic painter, Dalí was also a sharp businessman. The story goes that once Dalí had treated some friends at an expensive New York restaurant. When the time to pay for the meal came, Dalí instead of paying in dollars, like anyone else would have, decided to carry out a small experiment.

On the back of the cheque Dalí had signed to pay for the expensive meal, he drew a sketch in his inimitable style. He signed it and handed it to the waiter. The waiter passed it on to the manager.

The manager realised the value of what Dalí had given him and decided to frame the cheque and hang it on the wall, making sure that anyone who came to the restaurant saw it.

Of course, this meant that Dalí's cheque wasn't encashed and he didn't *really* have to pay in dollars for the expensive meal he had taken his friends out for.

This trick worked for Dalí. He was delighted and he used the same trick at different New York restaurants to pay for meals. The managers of all these different restaurants framed the cheque and hung it on one of the walls in their restaurants, so that everybody who came to the restaurant could see and realise that the famous painter Salvador Dalí had dined at the same place as they were.

This interesting story is recounted by Mauro F Guillén in his book *2030—How Today's Biggest Trends Will Collide and Reshape the Future of Everything* : "

Now what was happening here? If I can state this in simple English, Salvador Dalí, had turned his art into money. As Guillén writes:

> *"The money offered to pay for the meals was never deposited, as the cheques were transformed into artworks and took on a separate life. For Dalí, this maneuver was a stroke of genius. He could print his own money (his drawings had value), and people were willing to accept it as a form of payment."*

The trouble was Dalí went overboard and paid for one too many meals using this trick. In the end, the restaurant managers wised up and Dalí probably had to start paying real dollars for the expensive meals he took his friends out for.

What's the moral of this story? Anyone can create his or her own money as long as others are willing to accept it, though one thing needs to be kept in mind. As Guillén writes: "As with national currencies, any money can be felled by the laws of supply and demand, as an excessive supply depreciates its worth and reduces people's willingness to use it."

What Dalí ended up doing in a very small way, governments have done over and over again, over the centuries. They have gone overboard with printing money and spending it, created high inflation, as too much has chased the same set of goods and services, and in the process destroyed the prevailing form of money. (If you are interested in details, I would suggest that you read my Easy Money trilogy ).

Dear Reader, you must be wondering by now why am I recounting this story in a piece which is headlined to be about the bitcoin bubble. Have some patience, everything will become clear very soon. Read on.

*****

Bitcoin is a digital currency that does not use banks or any third party as a medium or at least that is how it is conventionally defined. It is governed by a string of cryptographical codes, which are believed to be military grade and very tough to break.

The price of a bitcoin has rallied big-time over the last few months. It rose from a little over $10,000 per bitcoin in early September to more than $40,000 per bitcoin in early January. As of January 8, 2021, the price of bitcoin touched an all-time high of $40,599.

One of the core selling points of bitcoins as well as its raison d'être is that unlike paper money they cannot be created out of thin air. The number of bitcoins is finite and the code behind it is so written that they cannot go beyond a limit of 21 million tokens.

Interestingly, mining, or the generation of a bitcoin, happens when a computer solves a complex algorithm. Anyone can try to mine bitcoins, but with a finite number being generated at regular intervals and with an increase in the number of people joining the mining race, it has become increasingly difficult to solve the algorithm and generate bitcoins.

As of January 11, 2021, the number of bitcoins in circulation stood at 18.6 million units . The rate at which bitcoins are being created has slowed down over the years and the last fraction of the 21 millionth bitcoin will be created only in 2140.

The larger point here is that unlike the paper money system (or to put it slightly more technically the fiat money system) which can be manipulated by central banks and the governments, the bitcoin system can't.

Hence, there is an overall limit to the number of bitcoins that can be created. This is the main logic offered in support of buying and owning bitcoins. Unlike central banks or governments or Salvador Dalí (in case you are still wondering why I started with that story), money in the form of bitcoin cannot be created out of thin air and beyond a certain limit.

In fact, this core idea/message at the heart of the bitcoin was built into the first fifty coins, now known as the genesis block, created by Satoshi Nakamoto, the mysterious inventor behind it. The beauty of bitcoin is that even not knowing who really Nakamoto is, doesn't impact the way the system he created, works.

The genesis block contained a headline from The Times newspaper published in London dated January 3, 2009. The headline was: " *Chancellor on brink of second bail-out for banks* ". The headline and the date are permanently embedded into the bitcoin data.

As Nakamoto wrote on a message board in February 2009: "The root problem with conventional currency is all the trust that's required to make it work… The central bank must be trusted not to debase the currency, but the history of fiat currencies is full of breaches of that trust. Banks must be trusted to hold our money and transfer it electronically, but they lend it out in waves of credit bubbles with barely a fraction in reserve. We have to trust them with our privacy, trust them not to let identity thieves drain our accounts."

Bitcoin was supposed to be this *grand idea* meant to save the world from the way the central banks and governments manipulate the paper money system. As William Quinn and John D Turner write in Boom and Bust—A Global History of Financial Bubbles : “To its advocates, bitcoin was the money of the future: it could not be devalued through inflation by a central bank, you could spend it on anything without having to worry about government interference or taxes, and it cut out the middleman, namely commercial banks.”

The question is, in these times of easy money, has bitcoin reached anywhere near its original goal or is it just another way of *pure speculation* .

Let’s look at this pointwise.

**1)** Here is a chart of the price of bitcoin in dollars since July 18, 2010 (I couldn’t find the price of bitcoin before this in the public domain, hence, the random date).


Source: https://in.investing.com/crypto/bitcoin/historical-data

It doesn't take rocket science to understand that if you have been a long-term investor in bitcoin, you would have made shitloads of money by now. But the fundamental question is, is bitcoin money or even the future of money, as it is made out to be, by those who are in love with it, or is it simply another form of speculation.

One of the key characteristics of money is that it is a store of value. The recent rally in bitcoin has led to many bitcoin believers telling us that bitcoin is a store of value. This comes from a very shaky understanding of what the term store of value *actually* means.

A store of value basically means that something has a stable value over time. As Jacob Goldstein writes in *Money: The True Story of a Made-Up Thing* : "If $100 buys your family a week's worth of groceries today, there is a very good chance it will buy approximately a week's worth of groceries a year from now. The dollar is a good store of value (it tends to lose about 2 percent of its value every year)."

Let's look at what has happened to bitcoin over the last few months. It rose from a little over $10,000 per bitcoin in early September 2020 to more than $40,000 per bitcoin in early January 2021.

As of January 8, 2021, the price of bitcoin touched an all-time high of $40,599. As I write this early in the morning on January 14, 2021, the price of a bitcoin is around $37,329. The price has fallen by 8% in a little over five days' time. So, where is the stability of value? And this isn't a one-off event. Bitcoin has moved rapidly up and down on many occasions.

But this is a very simple point. Here's the more complicated point . The price of a bitcoin as of September 5, 2020, was $ 10,092. On January 8, 2021, it reached $40,599, a rise of 302% in a matter of a little over four months.

If bitcoin really was money, using which we could make and receive payments and borrow and lend, the recent rally would have created a havoc in the economy.

What does the rise in the value of any form of money really mean? It means that the price of everything that money can buy is falling. And in this case prices would have fallen big-time. As Goldstein puts it: "This rise in the value of bitcoin would have caused a deflation far worse than the one in the Great Depression." Deflation is the scenario of falling prices and is deemed to be dangerous because people keep postponing their consumption in the hope of getting a lower price. This hurts businesses and the overall economy.

Now take a look at the following chart which plots the price of a bitcoin in dollars between December 2017 and December 2018.


Source: https://in.investing.com/crypto/bitcoin/historical-data

The price of a bitcoin as on December 16, 2017, was $19,345. A year later on December 15, 2018, it had fallen by 83% to around $3,229. What would this have meant if bitcoin really was money? It would mean that the price of money has fallen and hence, the price of other things has gone up. In this case, it would mean very high inflation, even hyperinflation.

In its current form, bitcoin is no store of value. If it was to be used as money, the world would hyperventilate between deflation and inflation.

**2)** Another key characteristic of money is that it is a medium of exchange or to put it in simple English, it can be used to buy things (like Dalí bought meals at expensive restaurants).

According to financial services company Fundera 2,352 American businesses, accept bitcoins as a payment. The United States is the mecca of bitcoin believers. As per the US Census Bureau there were around 7.7 million companies in the US with at least one paid employee. This statistic doesn't inspire much confidence. Barely anyone takes payments in bitcoins even in the United States.

Of course, it takes time for any new form of money to be adopted, but for something that has been around for 12 years, the rate of adoption seems quite poor.

Personally, I don't know of any business that accepts bitcoin as a payment in India. Maybe, there is some coffee shop in Bengaluru that does. Dear reader, if you know of it, do let me know.

**3)** The bitcoin believers like to compare it with gold. The reason gold has acted as a hedge against the proclivity of the governments and central banks to create paper money out of thin air, is that it cannot be created out of thin air. While alchemists, which included Isaac Newton as well, have tried this over the centuries, no one has been successful in developing a chemical formula that converts other metals into gold. Bitcoin works because of a similar dynamic, the believers tell us. There is a limit to the number of bitcoins that can be created and as time passes by it becomes more and more difficult to mine bitcoins. That's how the code behind bitcoin is written.

But the thing is that the code behind bitcoin is freely available. Anyone can take it and tweak it and come up with a new kind of money. Over the years this has happened and many of these new forms of money have ended up as *shitcoins* .

As Quinn and Turner write:

> *"In August 2016, one bitcoin was trading at $555; in the next 16 months its price rose by almost 3,400 per cent to a peak of $19,783.3 This was accompanied by a promotion boom, as a mix of cryptocurrency enthusiasts and opportunistic charlatans issued their own virtual currencies in the form of initial coin offerings, or ICOs. These coins had, on the face of it, no intrinsic value – to entitle their holders to future cash flows would have violated laws against issuing unregistered securities – but they nevertheless attracted $6.2 billion of money from investors in 2017 and a further $7.9 billion in 2018."*

A lot of this money never came back to the investors. There is no way to make sure that this won't happen in the future.

Also, at a broader level, a free market in money is a bad idea. The United States went through this situation sometime in the nineteenth century (Something I discuss in detail in the first volume of Easy Money ). It was very easy to get a banking license and banks could print their own money.

As Goldstein writes: "Not all banks were shady. Not even most banks were shady. But the notes printed by the shady banks looked as legit as the notes printed by the honest banks. And there were a lot of notes—at one point, the Chicago Tribune reported that the country had 8,370 different kinds of paper money in circulation." Imagine the confusion this would have created.

It was also easy for counterfeiters to manufacture their own paper money. In this scenario, a guide called Leonori's New York Bank Note List, Counterfeit Detector, and Wholesale Prices Current was published once a month. An issue of this guide, dated 18 November 1854, shows that 1,276 such banks were in operation in various states and 825 different kinds of forged notes were in circulation. The financial system was in a total anarchy.

While it is easy to make a case for a non-government decentralised money system, what may lie in store isn't something we may want in the first place. The sad part is very little thinking has happened on this front. Saying, let the best money win is a very insensitive way to go about it.

**4)** The bitcoin code which limits their number to 21 million units is written in C++. As Sean Williams writes on Fool.com : "Last I checked, code can always be erased and rewritten. While it's unlikely that a community consensus would be reached to increase the circulating supply of bitcoin, the possibility of this happening isn't zero." Anyway this possibility isn't going to arise until 2140, when the last fraction of the bitcoin will be mined, and by then you and I, won't be around. So, it doesn't really matter.


**5)** Let's talk a little more about paper money. Why do others accept it as money? Because they know that the government bank/central bank deems it to be money and hence, still others will accept it as money as well.

As L Randall Wray writes in *Modern Money Theory – A Primer on Macroeconomics for Sovereign Monetary Systems :*
" The typical answer provided in textbooks is that you will accept your national currency because you know that others will accept it. In other words, it is accepted because it is accepted. The typical explanation thus relies on an 'infinite regress': John accepts it because he thinks Mary will accept it, and she accepts it because she thinks Walmart will take it."

While this sounds correct there is a slightly more nuanced answer to the question.

There are three main powers that any government has: 1) The right to "legal" violence. 2) The right to tax. 3) The right to create money out of thin air by printing it.

As Wray writes:

> *"One of the most important powers claimed by sovereign government is the authority to levy and collect taxes (and other payments made to government, including fees and fines). Tax obligations are levied in the national money of account: Dollars in the*

> *United States, Canada, and Australia; Yen in Japan; Yuan in China; and Pesos in Mexico. Further, the sovereign government also determines what can be delivered to satisfy the tax obligation. In most developed nations, it is the government's own currency that is accepted in payment of taxes."*

What does this mean?

As Wray puts it:

> *"Ultimately, it is because anyone with tax obligations can use currency to eliminate these liabilities that government currency is in demand, and thus can be used in purchases or in payment of private obligations. The government cannot easily force others to use its currency in private payments, or to hoard it in piggybanks, but government can force use of currency to meet the tax obligations that it imposes… It is the tax liability (or other obligatory payments) that stands behind the curtain."*

Hence, the government creates demand for paper/fiat money by accepting taxes in it. This has ensured that the paper money system has kept going despite its weaknesses.

What this also means is that for bitcoin to become popular and move beyond the nerds, it needs a use case as solid as paying taxes in what government deems to be money, is.

It is worth remembering here what Wray writes: "For the past 4,000 years ("at least", as Keynes put it), our monetary system has been a "state money system". To simplify, that is one in which the state chooses the money of account, imposes obligations (taxes, tribute, tithes, fines, and fees), denominated in that money unit, and issues a currency accepted in payment of those obligations."

This is not to say that governments haven't destroyed money systems in the past. The history of money is littered with examples of kings, queens, rulers, dictators, general secretaries and politicians, representing governments in different eras, having destroyed different money systems at different points of time. But the government has always comeback and controlled the money system the way it has wanted to.

And unless governments and central banks start taking a liking to bitcoin, there is no way its usage is going to spread to a level where it can hope to challenge the prevailing paper money system. It is worth remembering that if governments start taking interest in bitcoin, it in a way beats the entire purpose behind its creation.

Also, every government will want to protect its right to create money out of thin air. Right now bitcoin is too small in the overall scheme of things for governments to be bothered about it and hence, they have largely humoured it (not in India though).

The market capitalisation of bitcoins (number of coins multiplied by the dollar price) as of January 8, peaked at around $759 billion. The global GDP in 2019 was around $88 trillion. So the price of bitcoin even at its peak was lower than 1% of the global GDP.

Hence, the bitcoin story is like that of a rich Indian father basically allowing his son to play around, until he thinks that the son now needs to grow up.

**6)** There is another point that needs to be made here regarding the paper money system. This is something I realised while writing the third volume of Easy Money and it makes me sceptical of anyone who wants to write off the paper money system in a hurry. (Before you jump on me for being a blanket supporter of the paper money system, I am not, but then that doesn't mean I don't see logical arguments when they are offered).

Many years back, in one of my first freelancing assignments, I happened to interview the financial historian Russel Napier. He explained to me the link between paper money and democracy. As he told me on that occasion:

> *"The history of the paper currency system, or the fiat currency system is really the history of democracy … Within the metal currency, there was very limited ability for elected governments to manipulate that currency. And I know this is why people with savings and people with money like the gold standard. They like it because it reduces the ability of politicians to play around with the quantity of money. But we have to remember that most people don't have savings. They don't have capital. And that's why we got the paper currency in the first place. It was to allow the democracies. Democracy will always turn towards paper currency and unless you see the destruction of democracy in the developed world, and I do not see that, we will stay with paper currencies and not return to metallic currencies or metallic-based currencies."*

Back then bitcoin wasn't really on the radar. The reason people with savings liked gold back then, is why many of them like bitcoins now.

The twentieth century saw the rise of both paper money and democracy. Pure paper money started coming into being after the First World War. The reason for this is very straightforward. In a democracy whenever there is a crisis, the politicians and the technocrats advising them need to be *seen to be doing something.*

As an ex-RBI Governor once told me, *do nothing cannot be a strategy* . And this need to be seen to be doing something, can most easily be fulfilled by manipulating the paper money system that prevails in a democracy. It gives central bankers the option of printing money and driving down interest rates in the hope that people will borrow and spend more and businesses will borrow and expand.

Of course, this has its own problems (as I keep highlighting in my pieces over and over again). But then, the prevailing system does really allow politicians to show that they are trying. Any other system would take this option away from politicians. Hence, the paper money system is not going to be replaced in a hurry. No government is going to let go of this privilege.

**7)** This is a slightly technical point, but I think it needs to be made. As I have mentioned through this piece, over the years it has become more and more difficult to mine bitcoins. Now bitcoin farms with giant racks of mining computers, are needed to mine bitcoins. The days when bitcoins could be mined using the processing power of a PC are long gone.

The bitcoin farms, as they are known as, need a lot of electricity. Hence, mining operations have moved to countries where electricity is cheap. They have moved to countries like Iceland, Mongolia and primarily, China.

This has created another problem. As Goldstein writes: "By the beginning of 2020, Chinese miners had grown so large that they controlled most of the processing power on the bitcoin network. And the way the code for bitcoin was written gave them control over the system."

While, bitcoin might be a decentralised democratic system running on code, but it's people who ultimately control the mining of bitcoins and hence, can direct its future.

So, will the future of bitcoin be driven by China? And if that turns out to be the case, what does this do to its chances of spreading as actual money, used in the selling and buying of things? There are no easy answers to these questions.

**8)** One of the key points of bitcoins was that it was a non-government decentralised money system which promised freedom from the middlemen. But that hasn't really happened. As Quinn and Turner write: "[Bitcoin] had promised freedom from middlemen, but trading it without a third party was cumbersome unless the user was expert in cybersecurity."

If you are using a broker to trade bitcoin it beats the entire idea of freedom from middlemen. Also, the moment you convert your money into fiat money and the money comes into your bank account, the entire idea of remaining unknown and the government not knowing what you are doing goes for a toss. Hence, you may have your reasons to buy bitcoins, but basically you are speculating.

**9)** You might want to ask why you haven't heard all this in the mainstream media. The reason for that lies in the fact that the incentives of the media are misaligned these days. Most investment related news is presented as a money-making opportunity. Hence, in this case the bitcoin believers have gotten more space and screen time in the media.

Many of the bitcoin believers are like the original investors in a Ponzi scheme. They have an incentive to talk up bitcoin, get more investors into it, drive up its price and make more money in the process. (In fact, these are precisely the kind of stock market investors that you get to see on TV and read in the media most of the time, but that is another topic for another day).

Also, given the extremely short attention spans that people have these days, the written word doesn't find much of an audience. As Quinn and Turner put it: "More fundamentally, the move away from the written word to television financial news, docusoaps and social media may corrode the ability of investors to think clearly and understand the complexities of the financial system."

You cannot understand economic history and the complexities of the financial system by watching TV or watching stuff over the internet or even listening to extremely detailed podcasts (podcasts can just give you a flavour of things and a feeling that you are actually learning a lot). The only way to understand complex issues is to read, read and read more.

In an era of short attention spans, bitcoins are just the right asset to speculate on. Their price goes up or falls even before you can say *Virat Kohli*. (This is another reason to support my writing ).

**10)** We live in an era of easy money. Central banks have printed trillions of dollars during the course of 2020 to drive down interest rates in the hope of encouraging people to borrow and spend and businesses to borrow and expand. Interest rates are in negative territory in some of the European nations.

In this scenario of very low interest rates, investors are desperate to earn returns. Hence, a lot of money has been invested into stock markets all over the world, driving them to levels not justified by earnings that companies are expected to earn in the years to come.

Some money has also found its way into bitcoins. As The Economist puts it : "The current surge seems to have been spurred by interest from the financial establishment, most of which had long scorned it." In simple English, hedge funds are buying bitcoins. Given that bitcoins are thinly traded, this has driven up prices by astonishing levels. Hence, like stock markets, bitcoin is also in bubble territory.

And as we have seen over the past few decades, hedge fund money can be quite mercurial. They can drive down prices faster than they drove them up.

To conclude, the fact that the price of bitcoin is so volatile tells us that most people investing in it aren't really bothered about the long-term story of bitcoin as money, the bitcoin believers try selling all the time. If they did believe in this story they would have bought bitcoin and held on to it. But as the crash of 2018 showed that is clearly not the case.

As Saifedean Ammous writes in *The Bitcoin Standard* , the bible of the bitcoin believers:

> *"Buying a Bitcoin token today can be considered an investment in the fast growth of the network and currency as a store of value, because it is still very small and able to grow many multiples of its size and value very quickly. Should Bitcoin's share of the global money supply and international settlement transactions become a majority share of the global market, the level of demand for it will become far more predictable and stable, leading to a stabilization in the value of the currency."*

(Ha ha, this is to show that I also read stuff I don't really agree with).

I am not clairvoyant. This may happen. This may not happen. My reading of economic history tells me it won't. But then I might turn out to be wrong. What do they say about history not repeating itself but rhyming? But what if it doesn't rhyme as well?

There are no guarantees when it comes to economics. The trouble is that while you are waiting for all this to happen, the price of a bitcoin is at the level of a very very very very expensive large cap stock and its volatility is that of a small cap penny stock.

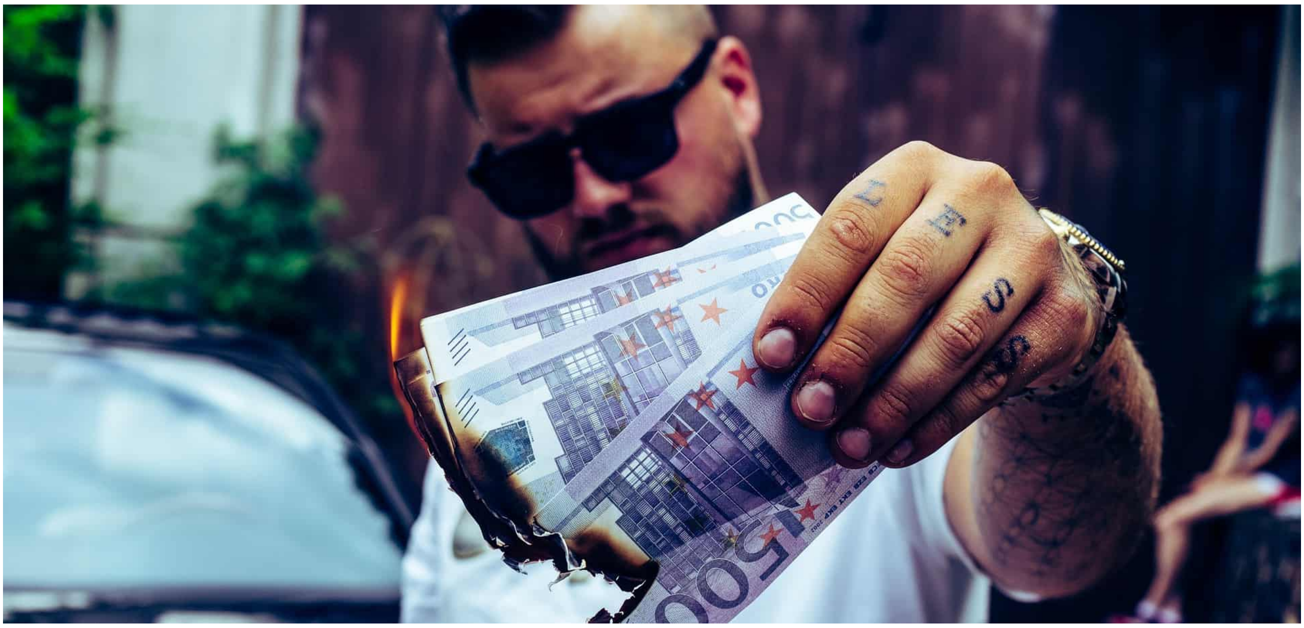
So, if you do invest in bitcoin, do understand that you are taking a punt, you are speculating, you are hoping that the price goes up and does not fall. Also, don't go looking for fundamental reasons for investing in it.

Given that investing in bitcoin is equal to taking a punt, please don't bet your life on it. As the old cliché goes, don't put all your eggs in one basket.

PS: This doesn't mean I don't believe in digital money. I do. But I also believe that it will be controlled by large corporations and the governments.

12 January, 2021

# Indian Banks Will Have Rs 17-18 Lakh Crore Bad Loans By September



The Reserve Bank of India (RBI) publishes the Financial Stability Report (FSR) twice a year, in June and in December. This year the report wasn't published in December but only yesterday (January 11, 2021).

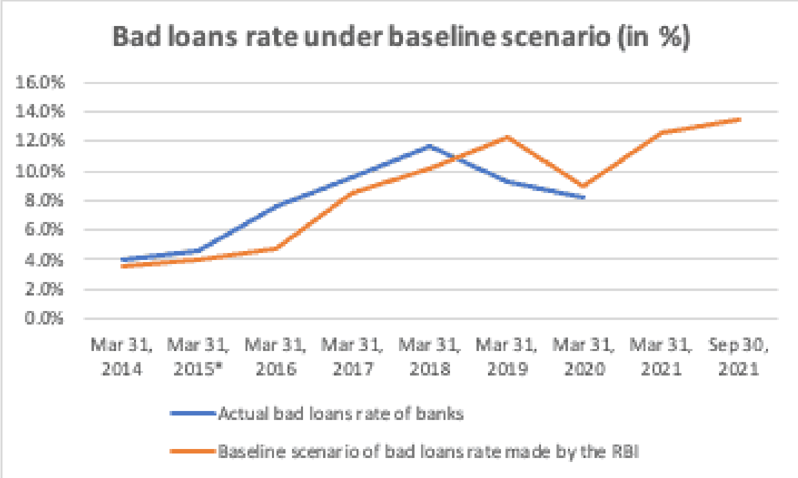
Media reports suggest that the report was delayed because the government wanted to consult the RBI on the stance of the report . For a government so obsessed with *controlling the narrative* this doesn't sound surprising at all.

Let's take a look at the important points that the FSR makes on the bad loans of banks and what does that *really* mean. Bad loans are largely loans which haven't been repaid for a period of 90 days or more.

**1)** The bad loans of banks are expected to touch 13.5% of the total advances in a baseline scenario. Under a severe stress scenario they are expected to touch 14.8%. These are big numbers given that the total bad loans as of September 2020 stood at 7.5% of the total advances. Hence, the RBI is talking of a scenario where bad loans are expected to more or less double from where they are currently.

**2)** Under the severe stress scenario, the bad loans of public sector banks and private banks are expected to touch 17.6% and 8.8%, respectively. This means that public sector banks are in major trouble again.

**3)** In the past, the RBI has done a very bad job of predicting the bad loans rate under the baseline scenario, when the bad loans of the banking system were going up.

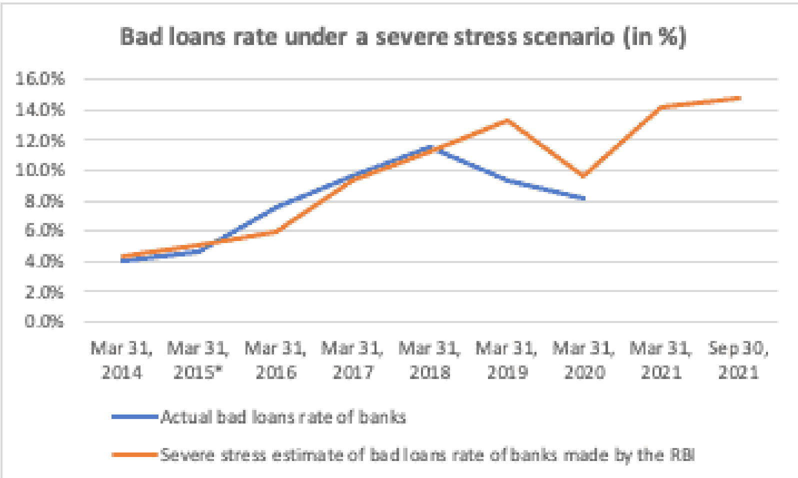



Source: Financial Stability Reports of the RBI.

*The actual forecast of the baseline scenario was between 4-4.1%

If we look at the above chart, between March 2014 and March 2018, the actual bad loans rate turned out to be much higher than the one predicted by the RBI under the baseline scenario. This was an era when the bad loans of the banking system were going up year on year and the RBI constantly underestimated them.

**4)** How has the actual bad loans rate turned out in comparison to the bad loans under severe stress scenario predicted by the RBI?




Source: Financial Stability Reports of the RBI.

*The actual forecast of the baseline scenario was between 4-4.1%

In four out of the five cases between March 31, 2014 and March 31, 2018, the actual bad loans rate turned out higher than the one predicted by the RBI under a severe stress scenario. As Arvind Subramanian, the former chief economic advisor to the ministry of finance, writes in *Of Counsel* :

> *"In March 2015, the RBI was forecasting that even under a "severe stress" scenario — where to put it colourfully, all hell breaks loose, with growth collapsing and interest rates shooting up—NPAs [bad loans] would at most reach about Rs 4.5 lakh crore."*

By March 2018, the total NPAs of banks had stood at Rs 10.36 lakh crore.

One possible reason can be offered in the RBI's defence. Let's assume that the central bank in March 2015 had some inkling of the bad loans of banks ending up at around Rs 10 lakh crore. Would it have made sense for it, as the country's banking regulator, to put out such a huge number? Putting out numbers like that could have spooked the banking system in the country. It could even have possibly led to bank runs, something that the RBI wouldn't want.

In this scenario, it perhaps made sense for the regulator to gradually up the bad loans rate prediction as the situation worsened, than predict it in just one go. Of course, I have no insider information on this and am offering this logic just to give the country's banking regulator the benefit of doubt.

**5)** So, if the past is anything to go by, the actual bad loans of banks when they are going up, turn out to be much more than that forecast by the RBI even under a severe stress scenario. Hence, it is safe to say that by September 2021, the bad loans of banks will be close to 15% of advances, a little more than actually estimated under a severe stress scenario.

This will be double from 7.5% as of September 2020. Let's try and quantify this number for the simple reason that a 15% figure doesn't tell us about the gravity of the problem. The total advances of Indian banks as of March 2020 had stood at around Rs 109.2 lakh crore.

If this grows by 10% over a period of 18 months up to September 2021, the total advances of Indian banks will stand at around Rs 120 lakh crore. If bad loans amount to 15% of this we are looking at bad loans of Rs 18 lakh crore. The total bad loans as of March 2020 stood at around Rs 9 lakh crore, so, the chances are that bad loans will double even in absolute terms. If the total advances grow by 5% to around Rs 114.7 lakh crore, then we are looking at bad loans of around Rs 17.2 lakh crore.

**6)** The question is if this is the level of pain that lies up ahead for the banking system, why hasn't it started to show as yet in the balance sheet of banks. As of March 2021, the RBI expects the bad loans of banks to touch 12.5% under a baseline scenario and 14.2% under a severe stress scenario. But this stress is yet to show up in the banking system.

This is primarily because the bad loans of banks are currently frozen as of August 31, 2020. The Supreme Court, in an interim order dated September 3, 2020, had directed the banks that loan accounts which hadn't been declared as a bad loan as of August 31, shall not be declared as one, until further orders.

As the FSR points out:

> *"In view of the regulatory forbearances such as the moratorium, the standstill on asset classification and restructuring allowed in the context of the COVID-19 pandemic, the data on fresh loan impairments reported by banks may not be reflective of the true underlying state of banks' portfolios."*

The Supreme Court clearly needs to hurry up on this and not keep this hanging.

**7)** Delayed recognition of bad loans is a problem that the country has been dealing with over the last decade. The bad loans which banks accumulated due to the frenzied lending between 2004 and 2011, were not recognised as bad loans quickly enough and the recognition started only in mid 2015, when the RBI launched an asset quality review.

This led to a slowdown in lending in particular by public sector banks and negatively impacted the economy. Hence, it is important that the problem be handled quickly this time around to limit the negative impact on the economy.

**8)** Public sector banks are again at the heart of the problem. Under the severe stress scenario their bad loans are expected to touch 17.6% of their advances. The sooner these bad loans are recognised as bad loans, accompanied with an adequate recapitalisation of these banks and adequate loan recovery efforts, the better it will be for an Indian economy.

**9)** At an individual level, it makes sense to have accounts in three to four banks to diversify savings, so that even if there is trouble at one bank, a bulk of the savings remain accessible. Of course, at the risk of repetition, please stay away from banks with a bad loans rate of 10% or more.

To conclude, from the looks of it, the process of kicking the bad loans can down the road seems to have started. There is already a lot of talk about the definition of bad loans being changed and loans which have been in default for 120 days or more, being categorised as bad loans, against the current 90 days.

And nothing works better in the Indian system like a bad idea whose time has come. This is bad idea whose time has come.

8 January, 2021

# All You Wanted to Know About India's Economic Contraction This Year

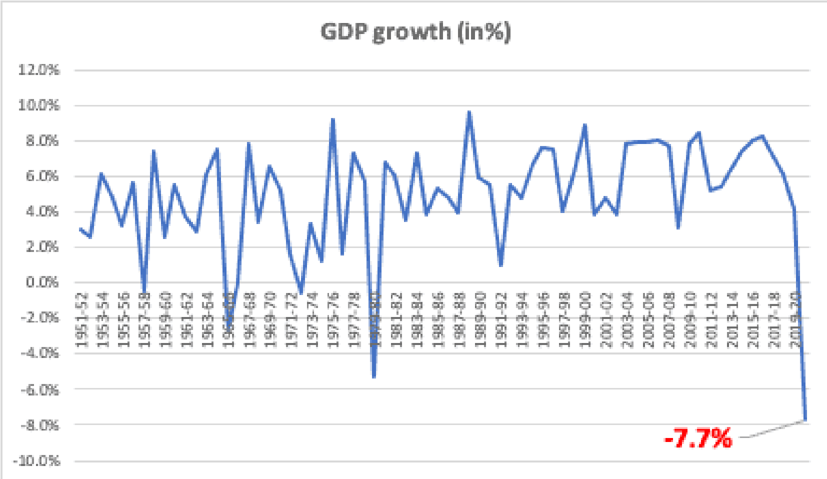
The National Statistical Office (NSO) published the first advance estimates of the gross domestic product (GDP) for 2020-21, the current financial year, yesterday.

The NSO expects the Indian GDP to contract by 7.7% to Rs 134.4 lakh crore during the year. The GDP is a measure of the economic size of a country and thus, GDP growth/contraction is a measure of economic growth/contraction. Data from the Centre for Monitoring Indian Economy (CMIE) shows that this is the worst performance of the Indian economy since 1951-52.

Let's take a look at this pointwise.

**1)** This is the fifth time the Indian economy will contract during the course of a financial year. The last time the Indian economy contracted was in 1979-80, when it contracted by 5.2%, due to the second oil shock.

Before 1979-80, the Indian economy had contracted on three occasions during the course of a year. This was in 1957-58, 1966-67 and 1972-73, with the economy contracting by 0.4%, 0.1% and 0.6%, respectively.




Source: Centre for Monitoring Indian Economy.

Hence, in the years after independence, the Indian economy has seen two serious economic contractions, the current financial year is the second one.

**2)** One way the GDP of any country is estimated is by summing the private consumption expenditure, investment, government expenditure and net exports (exports minus imports), during the year.

The government expenditure has always been a small part of the Indian economy. It was at 5.6% of the GDP in 1950-51. It has gradually been going up since then. In 2020-21, it formed 13% of the GDP, *the highest it has ever been* . This tells you the times that we are living in. The government expenditure as a part of the GDP has been going up since 2013-14, when it was at 10% of the GDP. Hence, the government has had to spend more and more money to keep the growth going over the last five to six years.

Given this, while the spread of the covid-pandemic has created a massive economic mess this year, the Indian economy has been slowing down for a while now. This is the broader message that we shouldn't miss out on, in all the song and dance around the economic recovery.

**3)** If we leave out the government expenditure from the overall GDP figure, what we are left with is the non-government GDP. This is expected to contract by 9.5% during this year, the worst since 1951-52. What this also tells us is that the non-government part of the economy which will form 87% of the economy in 2020-21, is in a bigger mess than the overall economy.

**4)** This isn't surprising given that investment in the economy is expected to contract by 14.5% during the year. What does this mean? It first means that for all the *positivity* that the corporates like to maintain in the public domain about the so-called *India growth story* , they clearly aren't betting much money on it.

As the new twist to the old proverb goes, the proof is in the pudding. During the period October to December, the new investment projects announced, by value, fell by 88%, and the investment projects completed, by value, fell by 72%. This is a period when corporates were *talking up* the economic recovery big time.

**5)** It is investments into the economy that create jobs. When the investments are contracting there is clearly a problem on that front. It also leads to the question of what happens to India's so-called demographic dividend.

One fallout of a lack of jobs has been the falling labour force participation rate, especially among women, which in December 2020 stood at just 9.28%. This is a trend that has been prevalent for five years now and Covid has only accelerated it. More and more women are opting out of the workforce.

**6)** Getting back to corporates. The profitability of Indian corporates went through the roof between July and September. This when the broader economy was contracting. How did this happen? The corporates managed to push up profits by driving down costs, in particular employee cost and raw material cost. While this is corporates acting rationally, it hurts the overall economy.

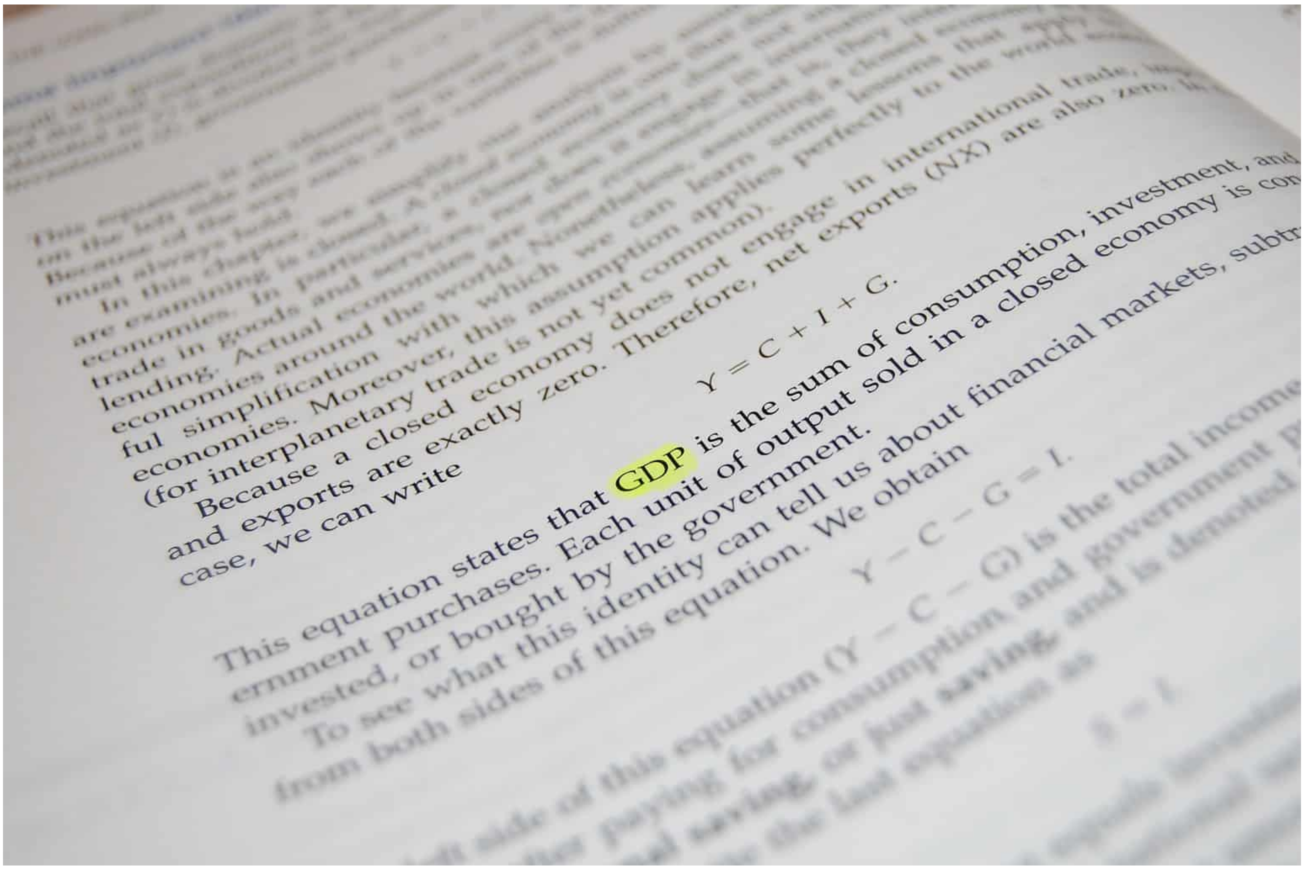
This means that incomes of those working for corporates and those dealing with them (their suppliers/contractors etc.) have come down. Net net this will hurt the overall economy and will eventually hurt the corporates as well, because there is only so much cost-cutting you can do. Ultimately, only higher sales can drive higher profits and for that the incomes of people need to grow.

**7)** It is hardly surprising that investments are expected to contract during the year, given that private consumption expenditure, the biggest part of the Indian economy, is expected to contract by 9.5% during the year. Ultimately, corporate investment leads to production of goods and services that people buy and consume, and things on the whole don't look too good on this front.

In fact, even in 2019-20, the last financial year, the private consumption expenditure had grown by just 5.3%, the worst in close to a decade. This again tells us that while covid has been terrible for the economy, things weren't exactly *hunky dory* before that.

**8)** The final entry into the GDP number is net exports. Typically, this tends to be negative in the Indian case, simply because our imports are much more than our exports. But this year that is not the case with net exports being in positive territory, the first time in four decades. This has added to the overall GDP. But is this a good thing? The exports this year are expected to contract by 8.3% to Rs 25.8 lakh crore. In comparison, the imports are expected to contract much more by 20.5% to Rs 24.8 lakh crore.

What does this tell us? It tells us that the demand for Indian goods in foreign countries has fallen because of covid. At the same time, the contraction of Indian imports shows a *massive* collapse of demand in India. Non-oil, non-gold, non-silver goods imports, are a very good indicator of consumer demand and these are down 25.3% between April and November this year, though the situation has been improving month on month.




**9)** There is another way of measuring the GDP and that is by looking at the value added by various sectors. If we were to consider this, agriculture growth during the year remains sturdy at 3.4%. While, this is good news on the whole, it doesn't do anything to change the fact that close to 43-44% of the workforce is employed in agriculture and contributes just 15% of the economic output.

Come what may, people need to *move away* from agriculture into professions which add more value to the economy. This hasn't been happening at the pace it should.

**10)** The non-agriculture part of the economy, which will form around 85% of the economy this year, is expected to contract by 9.4%, This clearly isn't good news.

**11)** Industry is expected to contract by 9.6%. Within industry, manufacturing and construction are expected to contract by 9.4% and 12.6%, respectively. The construction sector is a big creator of jobs, especially jobs which can get people to move away from agriculture. With the sector contracting, the importance of agriculture in the economy has gone up.

**12)** The services sector is expected to contract by 8.8%. Within this, trade, hotels, transport, storage and communication (all lumped into one, don't ask me why) is expected to contract by 21.4%. This isn't surprising given that people continue to avoid hotels and travelling, thanks to the fear of the covid pandemic.

**13)** The GDP during 2020-21 is expected to be at Rs 134.4 lakh crore. The GDP during 2019-20 was at Rs 145.6 lakh crore. Given this, when it comes to the GDP growth during 2021-22, the next financial year, the low base effect will be at play. Even if the GDP in 2021-22 touches the GDP in 2019-20, we will see a growth of 8.4%. Nevertheless, even with that sort of growth we will be just getting back to where we were two years ago.

In that sense, the covid pandemic along with the slow growth seen before that, has put India's economy back by at least two years.

To conclude, the economy will do much better in the second half of this financial year than the first half. In fact, it already is.

The question is whether this is because of pent up demand or covid induced buying or is a genuine economic recovery already taking place. I guess, there is a little bit of everything happening.

But how strong the economic recovery is, will only become clear in the months to come, as the covid induced buying, and buying because of pent up demand, start to dry out.

Watch this space!

6 January, 2021

# On Advice

I don't know why I am writing this. I guess, I need to get it out of my system. So, at the end of it if you are still wondering *why,* apologies in advance.

In the last eight to nine months, there has been a massive increase in the number of people writing to me, seeking advice on different issues.

Recently, someone wrote to me, wanting to know, if doing a five-year integrated MBA from one of the IIMs, was a good option, if one did not get admission into an IIT that is. My answer was, I don't know.

He persisted and asked, if spending Rs 30 lakh on an integrated five-year MBA from one of the IIMs, was really worth it? My answer was, I don't know.

He persisted and asked, if getting a degree in business or economics made a difference if one wanted to become an entrepreneur. My answer again was, I don't know.

He then thanked me for my suggestions.

Another gentleman had a degree in science and wanted to know if there was any course/internship/job that would help him learn finance. My answer was, I don't know.

Over the months, I have got many such questions where people seek career advice from me. And honestly, I don't know why they do this. I am not a career counsellor. My corporate career lasted all of five weeks.

And before that I more or less made a mess out of my education. My formal education is a BSc in Maths and Computer Science followed by an MBA in Information Systems. I lost interest in the MBA around half way through it, but didn't have the *guts* to drop out, thinking of all the money that had been spent and the problems it would create for my parents.

So, I persisted and ended up getting a degree which has been *largely* useless since then. The only thing that I learnt in my MBA and which I still put to good use is how to calculate the *internal rate of return* on any investment. But one didn't have to do an MBA just to learn that.

I have spent nearly two decades in trying to make up for this mistake, by making myself learn economics, personal finance and some part of the Income Tax Act, bit by bit, in an extremely unstructured way. (This also explains why I find it very difficult to answer questions like, which are the books I should read to learn economics).

All this unstructured learning could also happen because I lead a slightly unconventional life. I am single. I stay in a studio apartment. And I don't spend much money on travelling.

Hence, I have been able to dedicate a lot of time to unstructured learning. This is not a formula that would work for most people, especially those who have EMIs to pay, and given that I don't recommend it to anyone.

Also, the larger point here is, that I have a good understanding of things over a fairly limited area. I understand some fifth standard Maths and some part of India's economy. I can tell you how to manage your money, on most days, but there are a few limitations to that as well. And that's about it.

Beyond this, my knowledge is generally useless. I know a few things about Hindi cinema and its music, especially from the late 1980s to the mid 1990s. Like this morning I was discussing with someone, on how a famous Hindi film song of the mid 1970s composed by Laxmikant-Pyarelal, has a tune similar to a famous Sabri Brothers qawwali. But then I really don't know who copied whom.

I can also give you a lot of *gyan* on modern crime fiction, especially Scandinavian crime fiction and in particular, the genre of the police procedural. Like I can tell you why the last book in Henning Mankell's Kurt Wallander series just didn't make much sense and it was written by a writer who was extremely bored by then. But then what use will this be to you?

Of course, I have written five books in the last decade and these books have sold reasonably well and put me in the public domain. I have appeared on TV (I don't know why but this is equated to being successful in India. The day I first appeared on TV, one of my aunts just went over the moon. This was after nearly eight years of writing almost every day, first for a newspaper and then freelancing for websites, newspapers and magazines). I have lectured all across India. I have spoken across India's best business schools.

So, there has been some limited success in my life. But then that does not mean that I have answers to all the questions. Let me give you an example.

A few years back a cousin who wanted to a PhD wanted me to tell her if she should do major in marketing or in economics. Now given that I have no experience of doing a PhD from an American university, I was in no position to answer the question. And I told her so. But she persisted and so I answered.

I told her that she should do a PhD in economics, given that if she had to spend five years on studying something, it rather be something important. Coming from me that should have been hardly surprising. The logic being, what was the point in studying marketing for five years and learning how to sell more things to more people.

Now this is not to say that marketing is just that, it clearly isn't. It is a very important subject, which can make a lot of difference across various facets of life and it's not just about selling more things to more people. But then that is the way I was thinking at that point of time, in trying to answer a question, I wasn't qualified enough to do.

Thankfully, she did not listen to me, and chose to do a PhD in marketing.

The point being it is very important in life who you seek advice from. Wrong advice can prove to be very costly.

There is another dimension to advice, it is a very individual thing.

Around a decade back, an uncle of mine was after me to buy a house in Delhi. Delhi home prices in 2010 were at their peak and anything half decent in the city would have cost Rs 1.5-2 crore. I clearly did not have the capacity to take on a home loan that could have funded a home at that price and I told him so.

He persisted. If not Delhi, look at something in Greater Noida. I didn't, for the simple reason, I had no plans of living in and around Delhi at that point of time (nor do I currently).

Now ten years later was this a good decision? Yes, if you consider the fact that so many projects in Greater Noida were never completed. The builders took the money and disappeared. Also, I continue living in Mumbai.

And no, if you consider the fact, that I still don't own a home to live in.

At the end of the day, what advice one seeks and one takes, is a very individual thing.

Anyway, that was the rant. Now let me give you *some advice on advice.*

**1)** If you have to ask, ask pointed questions. Don't ask stuff like, how do I learn finance? First figure out what does the word finance mean to you.

**2)** I think, the first point needs to be stated again. Ask pointed questions. Don't ask stuff like, should I invest in bitcoins? The answer from my end will always be, I don't know. Simply because I don't know how you perceive risk, what kind of money you are in a position to lose and what is your current understanding of bitcoins (or any other investment avenue for that matter).

This is not to say that if you were to ask a question like this, people won't give you an answer. Many people will. But come what may that would be wrong advice.

**3)** Before asking a question, please think, whether the person you are putting the question to, has the capability to answer that question. Just because he has seen some success in some aspect of life, doesn't mean he has the answers to everything. Like a few months back, someone asked me, which laptop should I buy. I mean, *thoda to dimag lagao yaar.*

**4)** Don't ask philosophical questions related to your career. You might get an answer but that answer will be wrong. This reminds me of a question someone asked me around a year back. *How do I make decisions in my 20s that I don't regret in my 40s?* I almost fell laughing from the chair I was sitting on. Almost all decisions I made in my 20s, I regret in my 40s, expect for the fact that I started reading seriously only in my mid 20s and which is why there is a lot to catch up on.

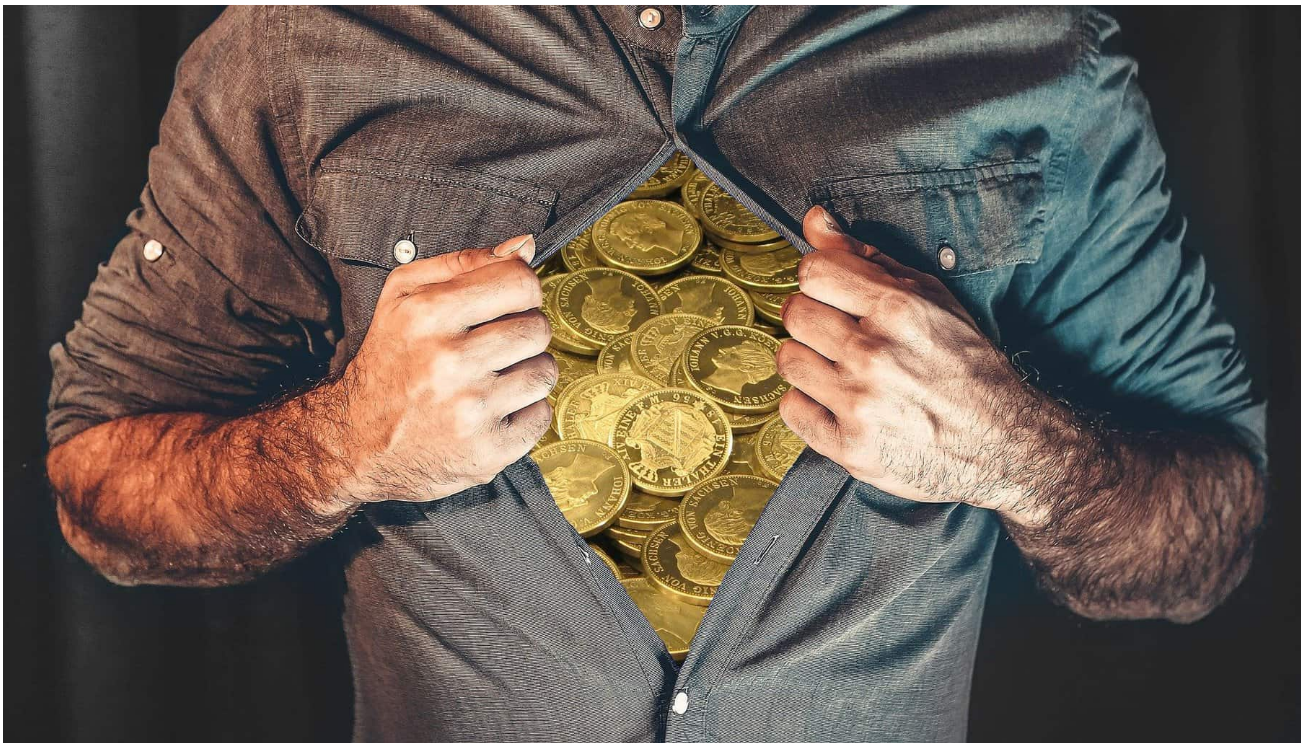
**5)** Just because you and I have been brought up writing exams where every question has an answer, doesn't mean life operates like that. Every question doesn't have an answer, even though most people will happily give you one. If you are the kind who believes in the fact that every question has an answer then please seek out LinkedIn influencers, you are *made for each other* .

**6)** Oh, and finally, please Google. *You will be surprised* !

**Bonus point:** Don't expect me to make a decision for you, simply because you are asking a question.

5 January, 2021

# The Rs 20 Lakh Crore Bad Loans Problem of Indian Banks Hasn't Gone Away



On December 29, 2020, the Reserve Bank of India (RBI) released the Report on Trend and Progress of Banking in India.

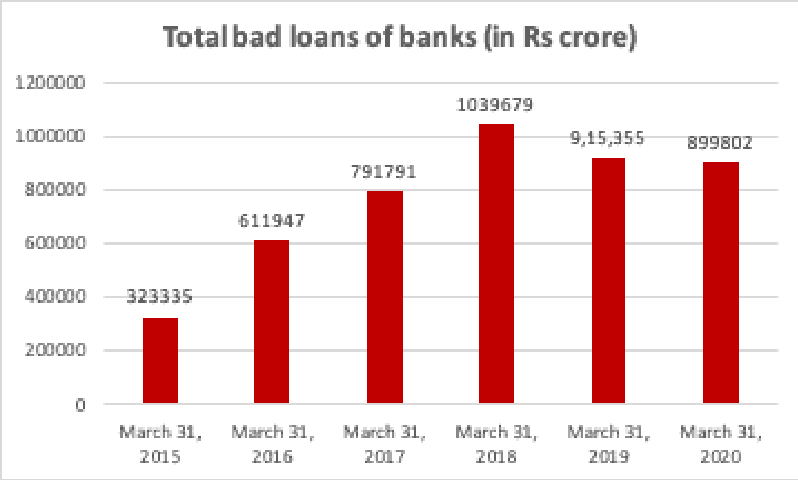
Like every year, the report is a treasure trove of information, especially for people like me who like to closely track the aggregate banking scene in India.

Sadly, most of this important information barely made it to the mainstream media, this, despite the fact that the health of the country's banking sector impacts almost all of us. (This is one reason why I need your continued support ).

Among other things, the report discusses the issue of the bad loans of banks in great detail. Bad loans are largely loans which haven't been repaid for a period of 90 days or more. They are also referred to as non-performing assets or NPAs.

Let's take a look at this issue pointwise.

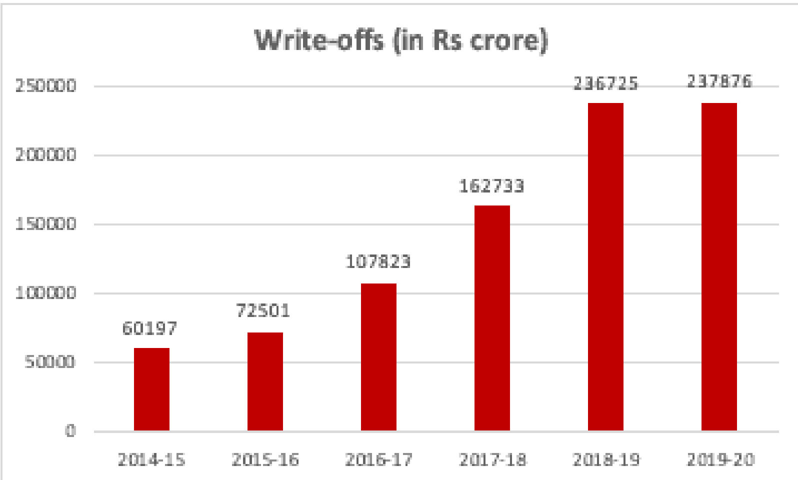
**1)** The total bad loans of banks (public sector banks, private banks, foreign banks and small finance banks) as of March 31, 2020 stood at around Rs 8,99,802 crore. This is the lowest since 2017-18. The following chart plots the bad loans of banks over the years.



Source: Reserve Bank of India.

Despite this fall, the Indian banking sector on a whole continues to remain in a mess. We shall look at the reasons in this piece.

2) The total amount of loans written off by banks has steadily been going up over the years. In 2019-20 it peaked at Rs 2,37,876 crore. The following chart lists out the loans written off by banks over the years.



Source: Reserve Bank of India.

Basically, loans which have been bad loans for four years (that is, for one year as a 'substandard asset' and for three years as a 'doubtful asset') can be dropped from the balance sheet of banks by way of a write-off. In that sense, a write-off is an accounting practise.

Of course, before doing this, a 100 per cent provision needs to be made for a bad loan which is being written-off. This means a bank needs to set aside enough money over four years in order to meet the losses on account of a bad loan.

Also, this does not mean that a bank has to wait for four years before it can write-off a loan. If it feels that a particular loan is unrecoverable, it can be written off before four years.

So, does that mean that once a loan is written off it's gone forever and is no longer recoverable? In India things work a little differently. In fact, almost all the bad loans written off are technical write-offs.

The RBI defines technical write-offs as bad loans which have been written off at the head office level of the bank, but remain as bad loans on the books of branches and, hence, recovery efforts continue at the branch level. If a bad loan which was technically written off is partly or fully recovered, the amount is declared as the other income of the bank. Having said that, the rate of recovery of loans written-off over the years, has been abysmal at best.

Now getting back to the issue at hand. The bad loans of banks as of March 31, 2020, have come down to some extent due to write-offs. As the Report on Trend and Progress of Banking in India points out: "The reduction in NPAs during the year was largely driven by write-offs." Interestingly, the RBI offers the same reason for bad loans coming down in the years before 2019-20 as well.

Let's try examining the above logic in a little more detail. The bad loans or NPAs of banks as of April 1, 2019, stood at Rs 9,15,355 crore. During the course of 2019-20, banks wrote off loans worth Rs 2,37,876 crore. Nevertheless, as of March 31, 2020, the bad loans of banks had come down to Rs 8,99,803 crore.

If we subtract the loans written off during 2019-20 from the overall bad loans of banks as of April 1, 2019, the bad loans as of March 31, 2020, should have stood at Rs 6,77,479 crore (Rs 9,15,355 crore minus Rs 2,37,876 crore). But as we see they are actually at Rs 8,99,802 crore.

What has happened here? What accounts for the significant difference? Banks have accumulated fresh bad loans during the course of the year. The net fresh bad loans (fresh bad loans accumulated during the year minus reduction in bad loans) during 2019-20 stood at Rs 2,22,323 crore. Once this added to Rs 6,77,479 crore, we get Rs 8,99,802 crore, or the bad loans as of March 31, 2020.

The point to be noted here is that banks on the whole have accumulated fresh bad loans of more than Rs 2 lakh crore during 2019-20. This is a reason to worry. It tells us that the bad loans problem of Indian banks hasn't really gone anywhere. It is alive and kicking, unlike what many bankers, economists, India equity strategists and journalists, have been trying to tell us. Many borrowers continue to default on their loans.

The net fresh bad loans accumulated in 2018-19 had stood at Rs 1,34,738 crore. This tells us that there was a huge jump in the accumulation of fresh bad loans in 2019-20. The current financial year will see a further accumulation of bad loans due to the covid-pandemic.

3) In a February 2017 interview to Dinesh Unnikrishnan of Firstpost , Dr KC Chakrabarty, a former deputy governor of the RBI and a veteran public sector banker, had put the bad loans number of Indian banks at Rs 20 lakh crore.

As he had said:

> *"I'll put the figure around Rs 20 lakh crore…One should include all troubled loans including reported bad loans, restructured assets, written off loans and bad loans that are not yet recognised."*

The trouble was not many people took Chakrabarty seriously at that point of time. Nevertheless, the Rs 20 lakh crore number doesn't seem far-fetched at all. As mentioned earlier, the bad loans number as of March 31, 2020, stood at Rs 8,99,802 crore.

Between 2014-15 and 2019-20, the total bad loans written off by banks was Rs 8,77,856 crore. We are taking this particular time period simply because in mid 2015 the RBI launched an asset quality review and forced banks to recognise bad loans as bad loans. Up until then the banks had been using various tricks to kick the bad loans can down the road.

If we add, the bad loans as of March 2020 to bad loans written off between 2014-15 and 2019-20, we get Rs 17,77,658 crore. What does this number represent? It represents the total bad loans, the Indian banks have managed to accumulate between 2014-15 and 2019-20. And it is very close to the Rs 20 lakh crore number suggested by Chakrabarty.

Of course, this calculation does not take into account the loans which are bad loans but have not yet been recognised as bad loans. Former RBI Governor Urjit Patel in his book *Overdraft—Saving the Indian Saver* writes:

> *"In February 2020, 'living dead' borrowers in the commercial real-estate sector – under a familiar guise ('a ghost from the past', if you will) viz., ad hoc 'restructuring' – have been given a lifeline. It is estimated that over one-third of loans to builders are under moratorium."*

Professor Ananth Narayan of the S. P. Jain Institute of Management and Research, writing in the Mint in June 2020, said: "Banking NPA recognition remains incomplete… For a while now, RBI has allowed banks to postpone NPA recognition for some of the over Rs 8 lakh crore of MSME, MUDRA and commercial real estate loans." The situation could only have worsened post the spread of the covid-pandemic.

If we take this into account, the bad loans of Indian banks over the last five years have amounted to much more than Rs 20 lakh crore. In that sense, Dr Chakrabarty has had the last laugh. As Chakrabarty had said in the Firstpost interview: "Unless this portion is recognised first, there will be no solution to the bad loan problem."

Or to put it simply, how do you solve a problem without recognising that it exists.

4 January, 2021

# 2021 – The Chinese Problem in Your Personal Finance

Dear Reader, before you start thinking that I have click-baited you one more time, let me assure you that's not true. Your personal finances in 2021 will *actually* face a Chinese problem.

But before we go into this, let's first understand a few aspects about the Chinese saving habit over the years. Let's look at this pointwise.

**1)** As is well known, the Chinese physical infrastructure over the years was funded through massive domestic savings being invested in bank deposits. As Charles Goodhart and Manoj Pradhan write in *The Great Demographic Reversal* : "Interest rates were set well below the rate of growth and the rate of inflation. While the economy grew on average by around 10% over 1990–2010, the inflation-adjusted deposit rate over the same period averaged −3.3% (for a 1.4% average for the nominal deposit rate versus an average annual inflation rate of 4.75%)."

Hence, the rate of interest rate was lower than the prevailing rate of inflation, for a period of two decades. If one were to state this in a simple way, the low interest rates acted effectively *as a tax on Chinese households* .

**2)** This tax did not *matter much* because the savings were channelised into investments. This created economic growth and the average income of a Chinese kept going up, year on year. Hence, while the interest being earned on the *accumulated wealth* was low, the regular yearly income kept going up.

**3)** Low interest rates led to an interesting behaviour at the household level. As Goodhart and Pradhan point out, there was "a negative correlation between urban savings and the decline in real deposit rates." "When banks fail to protect household savings, households tend to save more, not less, in order to achieve a 'target', whether that is for education or the purchase of a home."
Basically, given the negative real rate of interest on bank deposits, where inflation was higher than the interest rate, Chinese households saved more money in bank deposits in order to achieve their targeted savings. Options of investing in other avenues were *extremely* limited.

Now the question is how does all this apply to your personal finance in India in 2021. Allow me to explain pointwise.

**1)** Interest rates on bank fixed deposits have collapsed. The interest offered on fixed deposits of more than one year, currently stands at around 5.5% on an average. This when the rate of inflation as measured by the consumer price index in November 2020 stood at 6.93%. Hence, the real rate of interest is in negative territory. If after tax the rate of return on fixed deposits is taken into account, the gap gets even bigger.

**2)** The major reason for this collapse in interest rates has been a collapse in bank lending. Given that banks, on the whole, have barely given out fresh loans since March, they possibly couldn't keep paying a high rate of interest on deposits. Hence, the crash in interest rates. But what has added to this is the Reserve Bank of India (RBI) policy of flooding the financial system with money, in order to drive down interest rates further. The excess money in the financial system, which the banks deposit with the RBI, stood at Rs 6.25 lakh crore as of December 31, 2020.

3) From the indications that the RBI has given, this excess liquidity in the financial system is likely to continue. The idea is to help ease the burden on current loans of corporates. In a year the tax collections have collapsed this also helps the government to borrow at *extremely* low interest rates. At the same time, the hope is at lower interest rates corporates will borrow and expand. But that is not happening. Data from the Centre for Monitoring Indian Economy shows that announcements of new investment projects in terms of value fell by 88.3% during the period October to December 2020. Investment projects completed were down by 74%. So, the corporates aren't in the mood to borrow and expand.

There are a couple of reasons for this. Many corporates continue to remain over-leveraged. Still others don't have enough confidence in India's economic future, irrespective of what they say in the public domain. As they say, the proof of the pudding is in the eating.

4) *What does all this have to do with personal finance?* What happened in China is happening in India as well. The bank savings have gone up dramatically during 2020. Between March 27 and December 18, they were up by Rs 9.15 lakh crore. In comparison, the increase during similar periods in 2019 and 2018, had stood at Rs 4.35 lakh crore and Rs 3.90 lakh crore, respectively. Of course, all this increase in saving is not *just* because of low interest rates. Some of it is because of fewer opportunities to spend money in 2020. Some of it is because of

the general uncertainty that prevails. Some of it is because of jobs losses and the fear of job losses. And some of it is because Indians, like the Chinese, are saving more, in order to achieve the savings target for the education of their children or their weddings, or for the purchase of a home.

**5)** This has repercussions. With people saving more and with banks being unable to lend that money, interest rates have come down. And people saving more in response to the lower interest rates, means extended lower interest rates. This is not good news for savers. It is also not good news for consumption. If people are saving more, they are clearly spending lesser. This is the paradox of thrift or saving. When an individual saves more, it makes sense for him or her at an individual level. When the society as a whole saves much more than it was, it hurts the economy simply because one man's spending is another man's income. Over a period of time, this leads to job losses, more paradox of thrift and further job losses.

At the risk of sounding very cliched, there is no free lunch in economics. The RBI's policy of flooding the financial system with money in order to help the corporates and the government, is basically hurting individual savers, consumption and the overall economy. The savers are paying for this lunch. And unlike the corporates, the savers have no unified voice. The government, obviously, is the government.

While, there is no denying that with lending not happening bank deposit rates had to fall, but the RBI policy of driving them down further, is something that is hurting the economy.

**6)** So, where does that leave the Indian saver? Some individual savers are betting on the stock market. But the price to earnings ratio of the Nifty 50 index as of January 1, stood at 38.55, an all-time high level. If you have the heart to invest in stocks at such a level, best of luck to you. Some others are betting on bitcoin, which has given a return of more than 75% in dollar terms, in the last one month.

Also, unlike the Chinese, the prospects of an increase in the yearly income of an average Indian, over the next years, at best remain subdued. Hence, the humble Indian fixed depositor, who liked to fill it, shut it and forget about it, so that he could concentrate on many other issues that his or her life keeps throwing up, clearly has a problem in 2021.

To conclude, all of you who write to me asking for a safe way of investing so that you can earn a 10% yearly return, well, sorry to disappoint you, no such way exists. At least not in 2021. Of course, there are always Ponzi schemes to invest in, some fraudulent, and some not so fraudulent.

The choice is yours to make.

PS: Wishing all my readers a very Happy New Year. Hope 2021 is much better than 2020 was for each one of you.

20 December, 2020

# India might grow by 30% early next year, but that won’t mean much.

छोड़ो कल की बातें, कल की बात पुरानी
नए दौर में लिखेंगे, मिल कर नई कहानी
हम हिंदुस्तानी, हम हिंदुस्तानी
— Prem Dhawan, Usha Khanna, Mukesh and Ram Mukherjee in *Hum Hindustani*.

The Indian economy contracted by 7.5% during July to September 2020, in comparison with the same period in 2019.  When compared with a contraction of 23.9% during April to June 2020, a contraction of 7.5% looks *significantly* better.

Hence, there has been a lot of song and dance from the establishment and its supporters, on how quickly the Indian economy is recovering, especially when most economists expected the economy to contract by 10% during July to September and it contracted by only 7.5%. Terms like a *V-shaped recovery* have been bandied around a lot, over the last few weeks.

Nonetheless, India continues to remain in the bottom quartile, when it comes to economic growth/contraction of countries between July to September this year. Greece with an economic contraction of 11.7% is right at the bottom.

In fact, the song and dance of the establishment is likely to continue in the months to come and will reach its peak sometime in the second half of the next year, after the gross domestic product (GDP) figure for the period

April to June 2021, is published. GDP is a measure of the economic size of a country.

It is worth remembering here that the GDP during the period April to June 2020 contracted by nearly a fourth. The GDP during the period was Rs 26.90 lakh crore. In comparison, the GDP during April to June 2019 was at Rs 35.35 lakh crore.

So, the GDP during April to June 2021, will grow at a pace which has never been seen before. If it comes in at Rs 30 lakh crore, the growth will be around 11.5%. Given that, the GDP during the period July to September 2020 was already at Rs 33.14 lakh crore, the GDP during April to June 2021, is likely to be higher than that.

At a GDP of Rs 35 lakh crore, the economic growth during April to June 2021 will come in at a whopping 30.1%. Nevertheless, this is just an impact of what economists like to call the *low-base effect* .

A central government which can use a contraction of 7.5% to market itself, imagine the possibilities of what it can do if the economic growth rate crosses 30% in the first quarter of the next financial year.

While, some song and dance can do no harm to the economy, the real story needs to be understood and told as well. The real GDP in April to June 2021 will be more or less where it was during April to June 2019. In that sense, *we will be where we were two years back* .

Hence, the economic slowdown which started in mid 2018, along with the contraction that has happened post the spread of the corona epidemic, has pushed the Indian economy back by at least two years. Obviously, this can't be good news.

*Other than talking* , the central government hasn't done much to get the Indian economy going. Between April and October 2020, the government spent a total of Rs 16.61 lakh crore. In comparison, it had spent Rs 16.55 lakh crore during the same period in 2019. The difference being, this year we are in the midst of an economic contraction.

In a scenario where the corporates as well as individuals are going slow on spending money, government spending becomes of utmost importance. Between March 27 and November 20, the non-food credit of banks has gone up just Rs 26,496 crore.

Banks give loans to the Food Corporation of India and other state procurement agencies to buy rice and wheat, directly from the farmers. Once these loans are subtracted from the overall lending of banks what remains is non-food credit.

In comparison, the deposits of banks have gone up by Rs 8.03 lakh crore during the same period. This means just 3.3% of the fresh deposits that banks have got post March have been lent out.

What does this tell us? It tells us that both corporates and individuals are largely sitting tight and saving money. This is an indication of the lack of confidence in the near economic future. While the corporate executives might keep going gaga in the media about an economic revival, these numbers tell us a different story.

What hasn't helped is the fact corporates have reported bumper profits by driving down their raw material costs, input costs and employee costs. This basically means that along with employees, the suppliers of corporates have also seen an income contraction. This can't be good news for the overall economy.

The government's inability to spend, comes from the lack of tax revenues, something that is bound to improve in 2021-22. Other than that, the government hasn't gotten around to selling its stakes in public sector enterprises. Of the targeted Rs 2.1 lakh crore just 3% has been achieved. This is bizarre given that the stock market is at an all-time high-level.

Hopefully, the government will make up on this in the next financial year. Also, it can look at selling some of the land that it owns in prime localities in Indian cities.

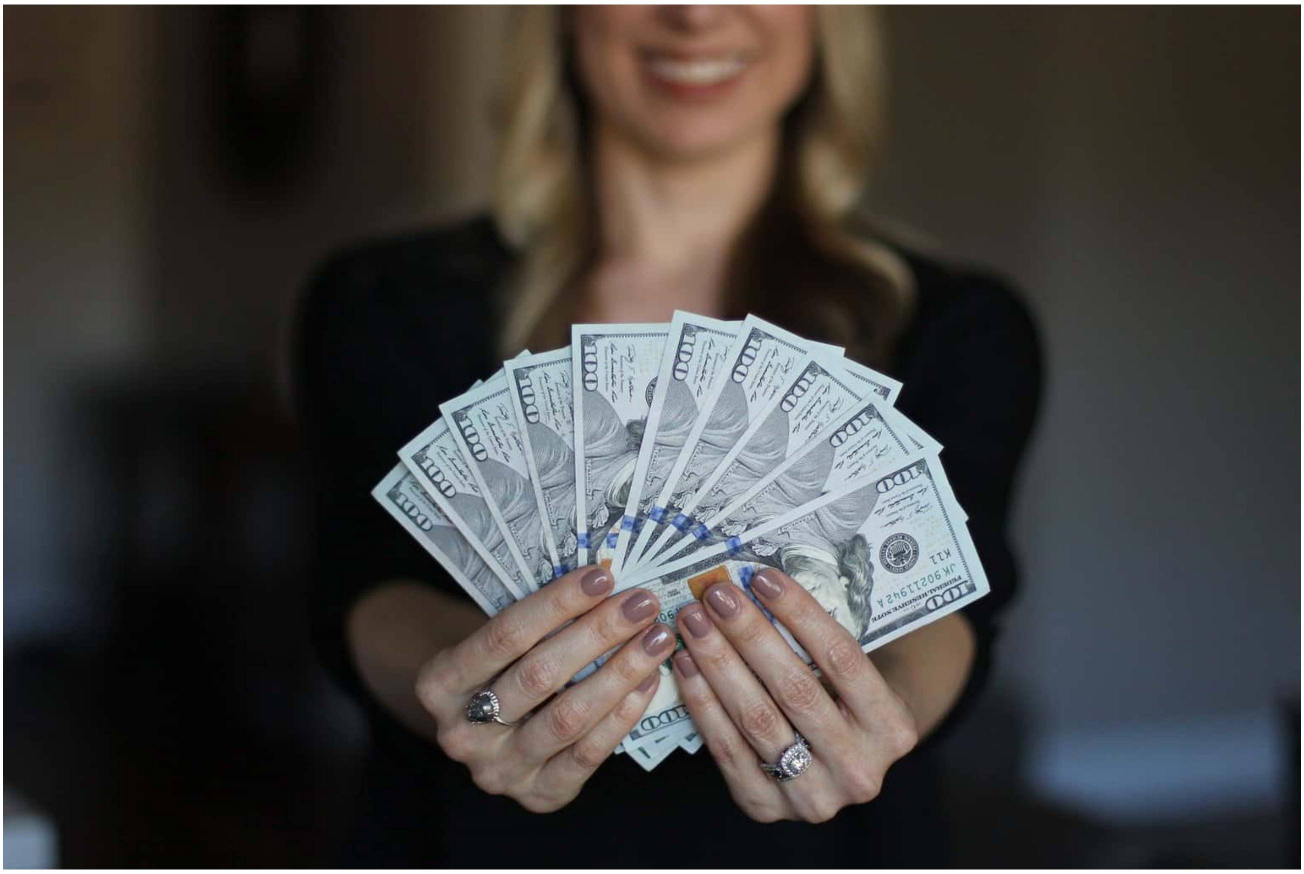
All this can be used to put more money in the hands of consumers through an income tax cut and a goods and services tax cut, encouraging them to spend.

People who pay income tax may form a small part of the population but they are the ones who actually have some *purchasing power.* And once they start spending more, the chances of it boiling down the hierarchy are higher. Do remember, at the end of the day, *one man's spending is another man's income* .

A slightly different version of this piece appeared in the Deccan Herald on December 20, 2020.

16 December, 2020

# 10 Things Women Can Do to Manage Personal Finances Better in 2021



***Aage aage wo chale peeche saari duniya***
***din na dekhe raat na dekhe peeche padi hai duniya***
***aur nahi koi aur nahi wo to hai rupaiya***
***gol gol chaand sa rupaiya***
***kaisa hai ye khwab sa rupaiya***

— Visheshwar Sharma, Kalyanji Anandji, Kishore Kumar and Surendra Mohan, in *Hiraasat* .

Okay, the headline was clickbait.

But now that I have your attention I have a few important things to share. I make a living by writing regularly on economics and finance. But this isn't how it always was.

For my first couple of years in journalism, I largely wrote on personal finance topics. It took me a couple of years to figure out that between the product sellers and the personal finance writers, the subject was made needlessly complicated.

The trick wasn't to try and understand every new product/idea that hit the market, which is what personal finance pages in newspapers and personal finance websites and magazines cater to, because they need to fill up space, so that they can gather advertisements against that space. Of course, personal finance writers need to keep writing about newer things and same things in newer ways, to keep their jobs.

When it comes to companies selling personal finance products, they are largely in the business of raising money and not *necessarily* managing it well

Hence, what is more important is to understand the broader principles of the subject and then stick to them over a period of time.

In the last fifteen years I have ended up advising more women on personal finance issues than men. In my limited experience, women seem to be more interested in understanding the nuances, the men typically play *know it all* when it comes to personal finance.

In this piece, I will elaborate on principles I think every woman should follow when it comes to managing her money and personal finances. (In fact, most of these principles can be followed by men as well, but then they know it already).

If you aren't following these principles, 2021 is just about here and now is as good a time to start as any.

Here we go:

**1)** Save for the sake of saving. This is a very simple principle but many women I have come across, just don't get it. They want to save for their next holiday, the next diamond ring, the next home, the next car, the children who aren't there yet, *the next whatever* …

In fact, Morgan Housel makes this point beautifully in his recent book *The Psychology of Money* : "Only saving for a specific goal makes sense in a predictable world. But ours isn't. Saving is a hedge against life's inevitable ability to surprise the hell out of you at the worst possible moment."

Like when the covid pandemic hit India in late March, people who had saved money for the sake of saving and had money in the bank account, were able to handle the situation in a much better way. If you lost your job and had money in the bank account you didn't have to take on the first new job that came along. You could wait for something better.

As Housel puts it: "Savings without a spending goal gives you options and flexibility, the ability to wait and the opportunity to pounce. It gives you time to think. It lets you change course on your own terms."

Further, if you save for the sake of saving and have money in the bank, you will be able to make the decisions, right or wrong, you want to make in life, and which might even mean not being pressurised by your family to get married to the next guy they discover on Shaadi.com.

If this isn't important I don't know what is. Hence, being financially independent is *very very important* and that can only happen if you save for the sake of saving.

In fact, as Housel puts it:

> *"We can leave aside rich, but independence has always been my personal financial goal. Chasing the highest returns or leveraging my assets to live the most luxurious life has little interest to me. Both look like games people do to impress their friends, and both have hidden risks. I mostly just want to wake up every day knowing my family and I can do whatever we want to do on our own terms. Every financial decision we make revolves around that goal."*

This should be the ultimate goal of saving and money in the bank account should not be a signalling effect for the society at large.

**2)** If you work for a company, be aware of how your salary is structured. Too many companies use the cost to company (CTC) approach to take their employees for a ride. If you don't understand the items that make up your salary, ask around, Google, do whatever is needed to understand them. I come across way too many women who work very hard on their job, but have no idea of their salary structure (This is not to even remotely suggest that men have it all figured out). If you have ESOPs as a part of your CTC, know when they will vest and when you can sell them. The same when it comes to the soft loans that you can take from the company. It's slightly difficult to understand this, but it's not rocket science.

**3)** I think this is the most important point that I will make in this piece. Way too many women I know, leave the managing of their finances to their fathers (a horrible horrible idea because they will make you buy LIC policies), spouses (might end up taking too much risk than you prefer) or boyfriends (you might just breakup, who knows).

I mean if you work so hard to earn the money that you do, why not spend some time to figure out how to manage it well. As I said earlier, *money in the bank,* helps us make the decisions that we want to. If you can spend a week planning a ten-day holiday that you take during the course of a year, I am sure you can spend a few days understanding how to manage the money you work so hard to earn through the year.

**4)** This is a tricky point and hasn't gone down too well with most women I have shared it with. Don't have all your money in joint bank accounts with your spouse (works for the husbands as well). I am not remotely trying to suggest that if things don't work out between you guys, he will cheat you on the money front (he may, but then who am I to suggest that). But untangling these things can be quite a pain.

So, it makes sense to have one joint account for the shared expenses, but beyond that have your money in your bank account. (Believe me, if things don't work out, you are going to thank me forever for this).

**5)** This is another tricky point. If your father/husband/boyfriend/brother manages your money, be aware of where that money is parked. Be aware of the loans your husband has taken on. Again, I am saying this from experience. Many women just tend to be totally unaware on this front and then one day when the father dies, the husband leaves or the boyfriend breaks up, the reality of the situation suddenly hits them. Just getting a bank account shut after someone's death can be a huge pain, if you are unaware of the details.

**6)** Many women don't like the idea of managing their money because they think there is a lot of maths involved in it (Again, this is not to suggest that men understand the maths). It's just basic fifth standard maths, which is not difficult to understand at all.

**7)** Make sure that you are making full use of the tax deductions available to you as a married couple. (Again, the husband may have no idea, doesn't mean you also don't).

**8)** Diamond jewellery looks great on you and please wear it by all means but don't go about buying diamonds all the time. It's a bad idea. Selling diamonds can be a difficult business in case of an emergency. (Don't believe me, just Google).

**9)** If you are starting out and don't know how to go about managing your money, just do a recurring deposit with a bank to start with. It won't give you a great return but some money will start accumulating and *some money is better than no money* . Also, don't buy an insurance policy unless your family is dependent on you or you have outstanding liabilities.

**10)** And finally, since we are about 2021, do remember that sometimes return of capital is more important than return on capital. 2021 will be that kind of year. Manage your money accordingly.

To conclude, these points go beyond doing the basic things, like investing regularly over a long period of time to ensure that you end up making decent returns and not necessarily the highest returns, not having all your investments in one asset class (diversification), buying a house to live in and thinking very carefully about buying another house, not over-leveraging yourself and not making any investment decisions which will keep you awake at night. Nothing is worth ruining a good night's sleep.

15 December, 2020

# China's Population Control Model is an Outdated and a Bad Idea for India

***Hum do hamare ho do,***
***paas aane se mat roko.***
— Indeevar, Rajesh Roshan, Amit Kumar, Sadhana Sargam and Rajesh Roshan, in *Jurm* (1990).

Here's a scene from a middle class Indian drawing room of the late 1980s and early 1990s. Four men are sitting and chatting.

"You know what India's biggest problem is?" asks the first.

"Our population," replies the second.

"The government should do something to control it," says the third.

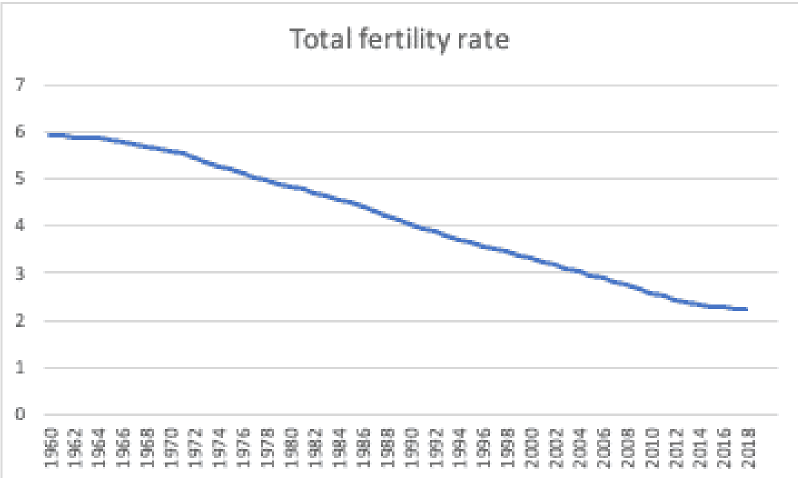
"Indeed," affirms the fourth.

Three decades and more later, whether similar conversations continue to happen in the middle class Indian drawing rooms, I have no idea, simply because I haven't been in one for many years. But some Indians still think in a similar fashion, that is, India has a population problem and that the government should do something to control it, like the way China did. ( *Okay, we might want to boycott Chinese goods but we don't have such inhibitions when it comes to their population control policy* ).

In fact, one such individual, even filed a public interest litigation with the Supreme Court and as reported in the Sunday edition (December 13, 2020) of The Times of India , pleaded that "to have good health; social, economic and political justice; liberty of thoughts, expression and belief, faith and worship; and equality of status and opportunity, a population control law, based on the model of China, is urgently required." ( *Ironically, the above paragraph mixes the Preamble of the Indian Constitution with the Chinese population control law).*

This is precisely the kind of *lazy thinking* that prevails when one forms an opinion on something and continues holding on to it, without looking at the latest data. Let's look at this issue pointwise, in order to understand that such thinking is totally wrong.

**1)** There is no denying that India has a large population and that creates its own set of problems, everything from lack of employment opportunities to lack of public infrastructure. But is population control the answer to that? No. Look at the following chart, which plots the total fertility rate of India.




Source: https://data.worldbank.org/indicator/SP.DYN.TFRT.IN?locations=IN

The total fertility rate in 2018 stood at an all-time low of 2.222. This meant that on an average 1,000 Indian women have 2,222 babies during their child-bearing years. The chart has a downward slope, which means that the fertility rate has been falling over the years. This means on an average Indian women have been bearing fewer children over the decades.

The replacement rate or the total fertility rate of women at which the population automatically replaces itself, from one generation to another, typically tends to be at 2.1. India's fertility rate is almost at the replacement level.

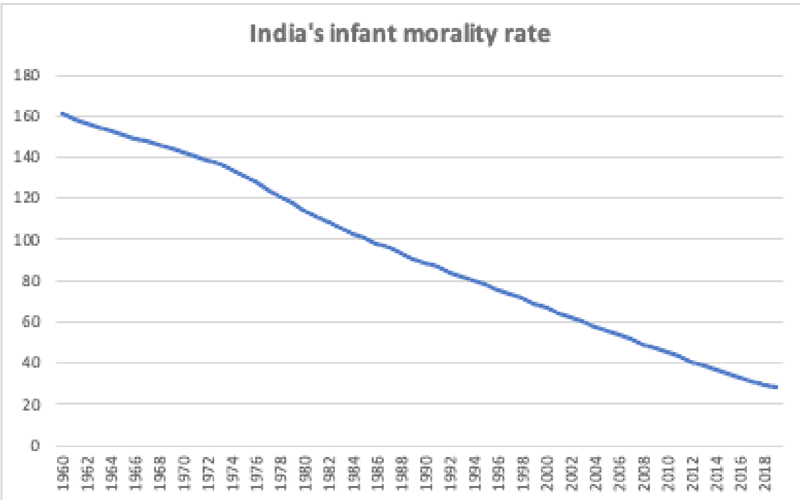
As per the Sample Registration System Statistical (SRSS) Report for 2018, the total fertility rate in urban India was 1.7 and in rural India was at 2.4. Hence, urban India is already below the replacement rate.

**2)** The point being that the Indian population is increasing at a much slower pace than it was in the earlier decades. How has that happened?

As Hans Rosling, Ola Rosling and Anna Rosling Rönnlund write in *Factfulness—Ten Reasons We're Wrong About the World – And Why Things Are Better Than You Think* :

> *"Parents in extreme poverty need many children… for child labour but also to have extra children in case some children die… Once parents see children survive, once the children are no longer needed for child labour, and once the women are educated and have information about and access to contraceptives, across cultures and religions both the men and the women instead start dreaming of having fewer, well-educated children."*

Hence, as the infant mortality rate falls due to a variety of reasons, from more women getting educated to a higher economic growth to urbanisation, the fertility rate comes down as well. Take a look at the following chart, which basically plots the infant mortality rate of India over a period of time. The infant mortality rate is defined as the number of children who die before turning one, per 1,000 live births.




Source: https://data.worldbank.org/indicator/SP.DYN.IMRT.IN

The infant mortality rate has fallen from 161 in 1960 to 28.3 in 2019. As more children born have survived and grown into healthy adults, parents have had fewer children. That is one clear conclusion we can draw here.

As the Roslings write: "Every generation kept in extreme poverty will produce an even larger next generation. The only proven method for curbing population growth is to eradicate extreme poverty and give people better lives, including education and contraceptives."

India's adult female literacy rate (% of females aged 15 and above) had stood at 25.68% in 1981. It has since gradually improved and in 2018 had stood at 65.79%. As more women have learned to read and write, the infant mortality rate and the fertility rate have both come down.

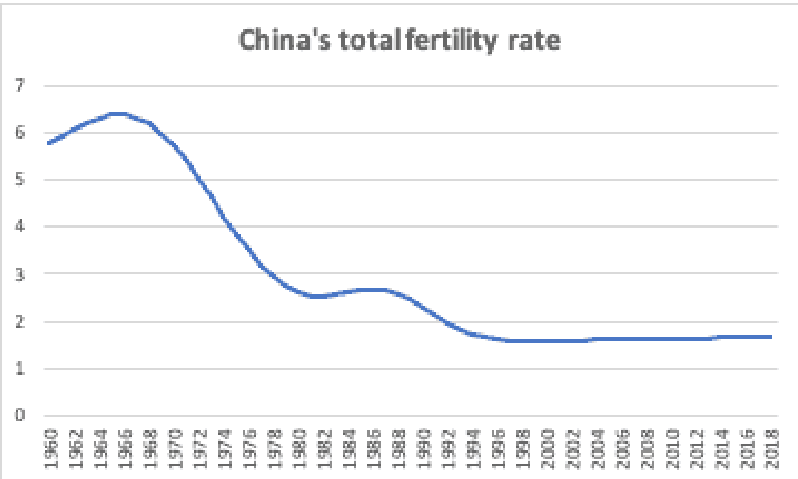
As the SRSS Report points out :

> *"On an average, 'Illiterate' women have higher levels of age-specific fertility rates than the 'Literate'. Within the 'Literate' group there is a general decline in the fertility rates with the increase in the educational status both in the rural and urban areas, barring a few exceptions."*

Also, faster economic growth post 1991 has helped in bringing down poverty levels and in turn led to a lower fertility rate as well.

In 1960, the total fertility rate was at 5.906. It fell to 4.045 by 1990. By 2018, it had fallen to 2.22. Clearly, the rate of fall has been faster post 1990.

**3)** Now let's talk about the China model of population control, which led to one Ashwini Upadhyay petitioning the Supreme Court, pleading that India adopt such a law as well. But before we do that let's look at the following chart which basically plots the total fertility rate in China over the years.




Source: https://data.worldbank.org/indicator/SP.DYN.TFRT.IN?locations=IN-CN

China's coercive one-child population control policy was launched in 1979. At that point of time, the Chinese fertility rate was 2.745. The interesting thing is that it had been falling rapidly from 1965 onwards when it had peaked at 6.385.

As Mauro F. Guillén writes in 2030: How Today's Biggest Trends Will Collide and Reshape the Future of Everything :

> *"Back in 1965, the fertility rate in urban China was about 6 children per woman. By*

> *1979, when the one-child policy came into effect, it had already declined all the way down to about 1.3 children per woman, well below the replacement level of at least 2 children per woman. Meanwhile, in rural China, fertility hovered around 7 children per woman in the mid-1960s, a number that decreased to about 3 by 1979."*

The point being that in 1979 when Chinese leaders pushed through the one-child policy the fertility rate in urban China was already at 1.3, much lower than the replacement rate. In rural China it was at 3, greater than the replacement rate of 2.1, but it was falling at a very fast rate. Hence, the decision to push through the one-child policy was not a data backed decision but basically politics.

As Guillén writes:

> *"The policymakers were unaware of the reality that fertility in China had been dropping precipitously since the 1960s, with most of the decrease driven by the same factors as in other parts of the world: urbanization, women's education and labour force participation, and the growing preference for giving children greater opportunities in life as opposed to having a large number of them."*

Clearly, Upadhyay like the Chinese before him, did not look at the Indian data before filing the public interest litigation in the Supreme Court and thus wasting the time of the Court as well as that of the government.

**4)** One of the impacts of the coercive one child policy in China was that parents preferred to have boys than girls. As Guillén writes: "While it was the law, the one-child policy created a gender imbalance of about 20 percent more young men than women, driven by the cultural preference for boys."

The male-female ratio went totally out of whack . In 1982 there were 108.5 male births per 100 female births. This went up to 118.6 per female births in 2005. It has since fallen to 111.9. This has led to an *intensified competition in the marriage market* , with many Chinese men being unable to find brides.

As per the Sample Registration System Statistical Report for 2018, India's sex ratio at birth was 1,000 males to 899 females. This works out to around 111 males for 100 females. Of course, like the Chinese even Indian parents have a cultural preference for a male child, who they believe will take care of them in their old age and also ensure that their family continues.

Imagine the havoc any coercive population control policy could have caused or can still cause, to the sex ratio in India.

In lieu of this fact, it was nice to see that the Modi government responded in an absolutely correct way in the Supreme Court. The health and family welfare ministry told the Court: "India is unequivocally against coercion in family planning… In fact, international experience shows that any coercion to have a certain number of children is counter-productive and leads to demographic distortion."

Clearly, the government doesn't want to become a victim of the law of unintended consequence where it wants to do one thing and ends up creating other problems. Kudos to that.

**5)** The Health and Welfare Statistics of 2019-20 project that India's total fertility rate will be 1.93 in 2021, which will be lower than the replacement rate of 2.1. It is expected to fall further to 1.80 by 2026-2030.

Of course, a fertility rate of close to the replacement rate doesn't mean that all states have low fertility rates. Recently, the data for  the first phase of the fifth National Family Health Survey (NFHS-5) was released. This had data for 17 states and five union territories. Among the large states, Bihar was the only state which had a total fertility rate greater than the replacement rate. The total fertility rate of the state stood at 3. (The data for other laggard states like Uttar Pradesh, Rajasthan, Madhya Pradesh etc., wasn't released in this phase).

A look at the data from Health and Welfare Statistics of 2019-20 tells us that the poorer states which have higher infant mortality rates also have higher fertility rates, most of the times. This evidence is in line with theory.

**6)** States with a lower fertility rate will not see an immediate fall in population. This is primarily because of the past high fertility rate because of which more people will enter or be a part of the reproductive age group of 15-49. This is referred to as the population momentum effect.

As C Rangarajan and J K Satia wrote in a column in The Indian Express in October : "For instance, the replacement fertility level was reached in Kerala around 1990, but its annual population growth rate was 0.7 per cent in 2018, nearly 30 years later." Nevertheless, population growth has slowed down and will continue to slow down further.

The larger point here being a growing population is a very important part of economic growth (of course, this is a necessary condition for economic growth but not a sufficient one).

As Ruchir Sharma writes in The 10 Rules of Successful Nations : "Throughout, increases in population have accounted for roughly half of economic growth… The impact of population growth on the economy is very straightforward, and very large. If more workers are entering the labour force, they boost the economy's potential to grow, while fewer will diminish that potential."

Many Indian states with a fertility rate lower than 2.1 will start facing the situation where fewer people will enter their workforce, in the next couple of decades. This includes Southern and the Western states. It also includes states like West Bengal, Punjab, Himachal Pradesh and Jammu and Kashmir.

Clearly, these states will need workers from other states to keep filling the gap in their working age population (something which is already happening). Also, as workers from high fertility states move to work in low fertility states, they will see an increase in their incomes. This will have an impact on their own fertility rates, which will fall.

In this scenario, states trying to reserve jobs for locals, is a bad idea in the medium to long-term, though it might work in the short-term by being politically popular. Also, states with lower fertility rates *on the whole* have higher per-capita incomes. Given that, locals do not always want to take on the low-end jobs. And for that, people from other states need to come in and take on those jobs.

People who move from less developed states to more developed states in India are those who are low-skilled or semi-skilled, largely. Alternatively, they have very high-level skills.

One indirect effect of a rise in migrants in any given state is that migrants spend a part of the money they earn and this leads to the overall increase in demand for goods and services within that state. It also leads to the government earning more indirect taxes.

This works well for the overall economy and the population as a whole though it may not be perceived in that way by the local population. As Abhijit Banerjee and Esther Duflo write in *Good Economics for Hard Times:* " Migrants complement, rather than compete with, native labour as they are willing to perform tasks that natives are unwilling to carry out."

To conclude, India has largely done whatever it had to stabilise its population growth, without resorting to any coercive policies (except for a short-time during the emergency). So, population growth has been slowing down for a while now and will continue to slowdown in the decades to come. In this environment, it is important to learn the right lesson from this entire issue, which is that societal level changes take time but they do happen at the end of the day, if the government keeps working towards it.

Also, going forward, it is important that young workers are allowed to move freely from one part of the country to another in search of an occupation; from the poorer parts to the better off parts.

As Rutger Bregman writes in *Utopia for Realists: The Case for a Universal Basic Income* : "Opening up our borders, even just a crack, is by far the most powerful weapon we have in the global fight against poverty."

Of course, Bregman is talking in the context of international migration, with people moving from poorer countries to richer ones. But there is no reason why the same logic can't apply to moving within the country as well.

**Postscript:** I just hope the Supreme Court judges are looking at the right data while listening to the PIL.

12 December, 2020

# The Curious Case of India's Two Wheeler Sales or Why Nothing is the Way It Seems

***Ik yaaron bullet bhi hua lakh da,***
***dooja yaaron mehanga petrol ho gaya.***

— Harkirat Singh Matharoo, Desi Crew and Jassimran Singh Keer in *Bullet.*

I have been following the issue of domestic two-wheeler sales on a regular basis. Two wheelers basically comprise of motorcycles, scooters and mopeds (around 6.37 lakh mopeds were sold in 2019-20).

Domestic two wheeler sales are a very important economic indicator which give us a good indication of the purchasing capacity of middle class India. Hence, it is important that they are interpreted in the correct way.

The sad part is that the *mainstream media* in its quest to get advertisements from automobile companies isn't really doing that.

For the last few months we have been told that two-wheeler sales have been going up in comparison to the same month in 2019.
Take the case for November 2020. Newsreports tell us that 1.6 million units of two-wheelers were sold during

the month and this was 13.4% more than the number of two-wheelers sold during November 2019.

Not for a moment I am suggesting the media is making this data up. They are simply reporting the numbers that the Society of Indian Automobile Manufacturers (SIAM) is providing them with. SIAM is basically the lobby representing major vehicle and vehicular engine manufacturers in India.

SIAM reports the number of units of two-wheelers leaving the gates of manufacturers or factory gate shipments. In simpler words, these are units which have been sold by manufacturers to dealers across the country, who in turn will sell to the end consumers. So, the SIAM data does not represent retail sales or the sales made to the end consumer. If we look at retail sales, the *real* situation is revealed and the picture that emerges is *not so pretty* .

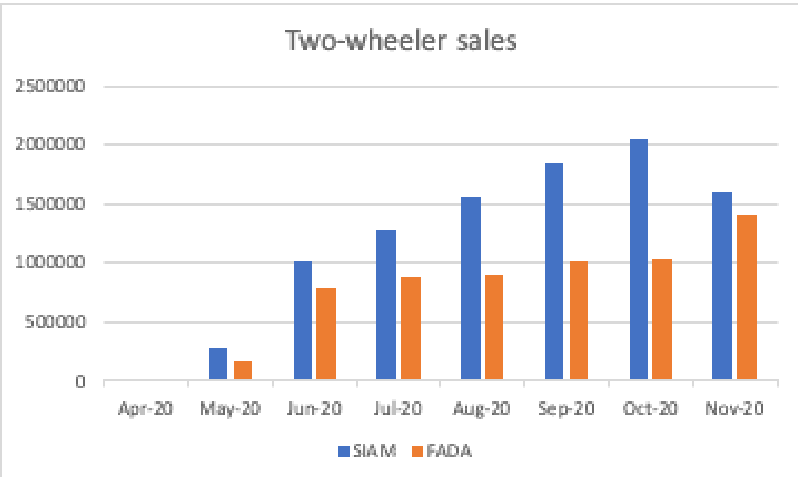
Let's take a look at this issue pointwise.

**1)** In November 2020, as per SIAM, 1.6 million units of two-wheelers were sold.  But what were the real sales like?

The Federation of Automobile Dealers Associations (FADA) reports the number of units of two wheelers registered at the Regional Transport Offices (RTOs) across the country after they have been sold to the end consumer. Hence, the sales number reported by FADA is a better representation of sales to end consumers. It uses the government's Vahan 4 database to report these numbers.

How many units of two-wheelers were sold in November as per FADA? 1.41 million units. This is lower than the number reported by SIAM. In fact, the difference is at 1.87 lakh units. This is the lowest difference between the SIAM and FADA numbers over the months since May 2020, when the difference was around 1.21 lakh units.

**2)** Take a look at the following chart. It plots the two-wheeler sales over the course of the current financial year (i.e. 2020-21), as reported by SIAM and FADA.




Source: SIAM and FADA.

As is clear from the above chart, in each month the SIAM sales numbers have been more than the FADA sales numbers. In fact, as per SIAM, a total of around 9.64 million units of two-wheelers were sold in India during this financial year. FADA puts the number at 6.19 million units, almost 36% lower. This is a difference of close to 3.45 million units.

**3)** What explains this difference? A small part of it stems from the fact that FADA sales numbers do not take into account sales made in the states of Andhra Pradesh, Telangana and Madhya Pradesh, which aren't yet on the government's Vahan 4 database, which FADA uses to publish the retail sales numbers. But retail sales in just three states can't explain a difference of 3.45 million units between the SIAM sales number and the FADA sales number.

**4)** So what does this mean? This basically means that while manufacturers have been selling two-wheelers to retailers and retailers haven't been able to sell a significant portion of what they have bought from manufacturers to the end consumer. *Channel stuffing* has been carried out and now the retailers have ended up with a significant amount of inventory. FADA suggests that the average inventory of two-wheelers with dealers is at 45-50 days. This is at the end of the festival season. Last year, at the end of the festival season the two-wheeler retailers had an average inventory of 35-40 days. What this means is that channel stuffing has gone up during the course of this year and last year's problem has continued taking on an even bigger form.

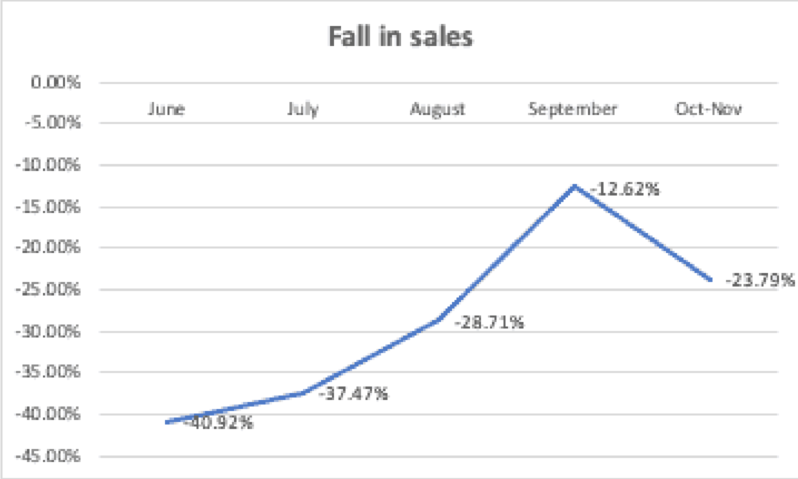
**5)** Why has channel stuffing gone up? A possible explanation for this lies in the fact that both manufacturers and retailers stocked up in the hope of sales picking up during the festival season. In fact, the sales did pick up in November, with 1.41 million units and more (if we take three states for which FADA does not have data for), being sold at the retail level, the best during the course of this financial year. But this best wasn't good enough to exhaust a bulk of the inventory build up that happened, given that retailers still have close to 50 days inventory.

Interestingly, if we look at the total sales of two-wheelers as per FADA during the 42-day festival season, from Navratri to Diwali, they were at 2.03 million units, 6.3% lower than last year. Clearly, when it comes to two-wheelers, the bets of both the manufacturers and retailers have turned out to be way too optimistic. The so-called revival in sales as per SIAM can be correctly interpreted as scooters and motorcycles stored in godowns of retailers, *waiting to be sold* .

**6)** So how bad is the situation? Let's concentrate on FADA data for this, simply because it represents real consumer sales. Also, let's ignore the months of April and May, when a lockdown to prevent the spread of the covid pandemic was in place and very little actual sales happened at the retail level. How do things look between June and November 2020, in comparison to the same period in 2019?

Around 6.04 million units were sold at the retail level between June and November 2020, which is 28% lower than the 8.38 million units sold during the same period last year. Clearly, retail sales have taken a huge beating.

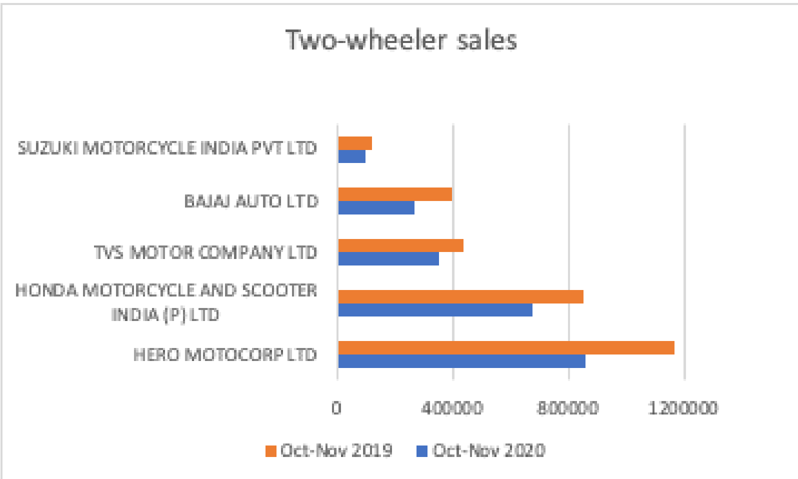
Take a look at the following chart, which plots the fall in retail sales which happened in a given month this financial year vis a vis last financial year. Also, I have considered sales in October and November together simply because the festival of Diwali was in October last year and in November this year. This makes the comparison more robust.




Source: Author calculations on FADA data.

As can be seen, the fall in sales this year was at 40.92% in June. (I have ignored the April-May data because of the lockdown). The fall was at 12.62% in September. In the festival season of October-November it stood at 23.79%. This is a worrying sign.

**7)** A few two-wheeler manufacturers have made a lot of *song and dance* about their sales over the last few months. Let's take a look at how things look for them during the months of October and November this year vis a vis last year. This is FADA data, hence, the usual disclaimer applies.




Source: Author calculations using FADA data.

As can be clearly seen from the above chart, the sales of the five largest two-wheeler companies during October and November this year, have been lower than the last year. On the whole, their sales were 2.25 million units, around a quarter lower than last year. The question is: what was the song and dance all about. *Pleasing the government?*

Finally, what will the future look like? Let's take a look at this pointwise.

**1)** With an inventory of around 50 days at the retail level, the number of two-wheelers leaving the factories of two-wheeler manufacturers in the months to come will come down, unless retail sales improve dramatically.

This has already happened in November with the difference between SIAM data and FADA data narrowing. The chances of retail sales picking up dramatically are low.

**2)** As far as retail sales are concerned, it will be interesting to see how the post-festival season period will play out. Clearly, the months of October and November were not as good this year as they were last year.

**3)** Also, it needs to be kept in mind that a good portion of the sales during June to November, would have been pent up demand or people who wanted to buy a two-wheeler during April and May, and couldn't buy due to the lockdown. Further, a significant number of people must have bought two-wheelers over the last few months to avoid taking public transport. Has this demand exhausted? It is difficult to answer this question with total certainty, nevertheless, a significant portion of this demand must have led to purchases by now.

**4)** How the banks go about lending two-wheeler loans in the months to come will be interesting to watch. Thanks to a case which is currently on in the Supreme Court, banks haven't gotten around to marking retail loans of under Rs 2 crore which have gone bad, as bad loans.

To conclude, it will be interesting to see how two-wheeler sales go in the remaining part of the year. From what data and logic currently suggests, things will continue to remain difficult this year. And that in turn suggests that the ability and the mindset of the Indian middle class to pay EMIs at this juncture will continue to remain limited.

Finally, petrol prices are on their way up.

***Mannubhai motor chali pum pum pum.***
— Rajendra Krishan, Laxmikant Pyarelal, Kishore Kumar, Asrani and Sikandar Khanna, in *Phool Khile Hain Gulshan Gulshan.*

9 December, 2020

# Amitabh Kant, the Indian Middle Class and their Dream of a Benevolent Autocrat

***Dekh tere sansar ki halat kya ho gayi bhagwan,***
***Kitna badal gaya insaan, kitna badal gaya insaan.***

— Kavi Pradeep, C Ramachandra, Kavi Pradeep and IS Johar, in *Nastik* (1954).

Sometime in late December last year I was part of a panel deliberating on where the Indian economy is headed, at a business school in Mumbai.

Towards the end of the discussion, a fund manager sitting towards my right, offered his final reason on why the so-called *India growth story* was faltering. He said, *India has too much democracy.*

The room was full of MBA students, just the kind of audience which laps up reasons like the one offered by the fund manager. As soon as he finished speaking, I explained to the audience why the fund manager was wrong, not just because India and the world need democracy, but also from the point of view of economic growth.

Of course, that wasn't the first time I had heard the *too much democracy* argument being made in the context of it holding back India's economic growth. Over the years, I have seen, friends, family members, random acquaintances and men and women I don't know, make this argument with panache and great confidence.

It seemed, as if, in their minds, they had a picture of this great leader who would come on a white horse, brandishing his sword, and set everything right. They wanted India to be governed by a *benevolent autocrat.*

Given this, it is hardly surprising that Amitabh Kant, the CEO of the NITI Aayog, and one of central government's top bureaucrats, said yesterday (December 8, 2020): "Tough reforms are very difficult in the Indian context, we are too much of a democracy."

The thinking here is that given that India is a democracy, decision making takes time and effort and you can't just push through economic reforms which *can* lead to economic growth. Getting things done needs a collaborative effort and hence, is deemed to be difficult. Hence, it would be great to have less democracy, making it easier for a strong leader to push economic reforms through.

Of course, the mainstream media has largely ignored Kant's comment. But this is an important issue and needs to be discussed.

The question is where does the thinking of too much democracy come from.

Some of it is remnant from the emergency era of 1975-1977, when trains used to apparently run on time. *Trains not running on time* was basically a manifestation of the general frustration of dealing with the so-called Indian system.

The logic being that, with the then prime minister Indira Gandhi keeping democracy on a backseat, it essentially ensured that the system (represented by trains) actually worked well (represented by trains running on time).

In the recent years, *too much democracy* hurting India's future economic prospects comes from the economic success of China. China doesn't have democracy. The Chinese Communist Party governs the country. In fact, there is no difference between the Party and the government.

This essentially has ensured they can push economic growth without any resistance from the opposition, different sections of the society or the citizens themselves for that matter.

China is not the only example of this phenomenon. Countries like South Korea under Park Chung-hee, Taiwan under Chiang Kai-shek and Singapore under Lee Kuan Yew, made rapid economic surges under leaders who can be categorised as benevolent autocrats.

As economist Vijay Joshi said at the 15th LK Jha memorial lecture at the Reserve Bank of India, Mumbai, in December 2017:

> *" Fewer than half-a-dozen of the 200-odd countries in the world have achieved super-fast and inclusive growth for two or more decades on the run, and almost all of them were autocracies during their rapid sprints."*

So, history tells us that most super-fast growing countries at different points of time have been autocracies.

Beyond this, there is the so-called *India growth story* which also leads to the sort of thinking which concludes that too much democracy hurts economic growth. Ravinder Kaur makes this point beautifully in *Brand New Nation—Capitalist Dreams and Nationalist Designs in Twenty-First-Century India* .

As she writes:

> *"What is dubbed a growth story in policy-business circles is essentially an enchanting fairy-tale blueprint of economic reforms along with calls of a strong political leader to implement it… After all, capital has always rooted for strong, decisive leaders and centralized governance that can ensure its swift mobility and put the nation's resources at the disposal of investors."*

A good part of India's corporate and non-corporate middle class buys into this kind of thinking. They look at themselves as investor-citizens.

This leads to the firm belief that autocracies lead to faster economic growth. Hence, too much democracy is bad for economic growth. Only if India had a stronger leader. QED. Or so goes the thinking.

Dear Reader, this is nothing but very lazy thinking. While, most super-fast growing countries may have been autocracies with a benevolent autocrat at the top, the real question is, are all autocracies with a benevolent autocrat at the top, or at least most of them, super-fast growing countries.

Economist William Easterly makes this point in a research paper titled *Benevolent Autocrats.* As he writes: "The probability that you are an autocrat IF you are a growth success is 90 percent. This probability seems to influence the discussion in favour of autocrats."

But that is the wrong question to ask. The question that needs to be asked should be exactly opposite—if a country is governed by an autocrat what are the chances that it will be a growth success? Or as Easterly puts it: "The relevant probability is whether you are a growth success IF you are an autocrat, which is only 10 percent."

And this is where things get interesting, if we choose to look at data. Ruchir Sharma offers this data in his book *The Ten Rules of Successful Nations* . Let's look at this pointwise.

**1)** In the last three decades, there were 124 cases of a country growing at faster than 5% for a period of ten years. Of these, 64 growth spells came under a democratic regime and 60 under an authoritarian one. Clearly, when it comes to countries growing at a reasonable rate of growth for a period of ten years, democracies do well as well as authoritarian regimes.

**2)** Let's up the cut off to an economic growth of 7% or more for a period of ten years. How does the data look in this case? Sharma looked at data of 150 countries going back to 1950. He found 43 cases where a country's economy grew at an average rate of 7% or more for a period of ten years. Interestingly, 35 of these cases came under authoritarian governments. As mentioned earlier, super-fast growth and autocrats go together. But this just shows one side of things.

**3)** So, what's the other side? While super-fast growth in a bulk of cases has happened under authoritarian regimes, so have long economic slumps or economic slowdowns.

As Sharma writes:

> *"Long slumps are also much more common under authoritarian rule. Since 1950, there have been 138 cases in which, over the course of a full decade, a nation posted an average annual growth rate of less than 3 percent—which feels like a recession in emerging countries. And 100 of those cases unfolded under authoritarian regimes, ranging from Ghana in the 1950s and '60s to Saudi Arabia and Romania in the 1980s, and Nigeria in the 1990s. The critical flaw of autocracies is this tendency toward extreme, volatile outcomes."*

Also, under authoritarian regimes, economic growth can see wild swings.

So, for every China there is a Zimbabwe as well, which people forget to talk or think about. For every Singapore, there are scores of African dictators who killed thousands of people during their rule and destroyed their respective economies. Hence, while autocracies may lead to super-fast growth, they can also lead to long-term economic stagnation and *huge* political turmoil.

Also, evidence is clear that steady growth happens best in democracies.

As Sharma writes:

> *"Together, Sweden, France, Belgium, and Norway have posted only one year of growth faster than 7 percent since 1950. But over that time, these four democracies have all seen their average incomes increase five- to sixfold, to a minimum of more than $30,000, in part because they rarely suffered full years of negative growth."*

Further, if you look at the list of countries with a per-capita income of more than $10,000, all of them are democracies. China, as and when it reaches there, will be the first autocracy, which will make it an exception. An exception, which proves the rule. That is, in the medium to long-term, democracy and economic growth go hand in hand.

At least, that's what history and data tell us. But don't let that come in your way of believing the good story of authoritarian regimes run by benevolent autocrats leading to fast economic growth all the time.

It must be true if you believe in it. I mean, Mr Kant surely does. And so do a whole host of middle class Indian men and women.

8 December, 2020

# Rising Corporate Profits Aren't Good News for Indian Economy

***Salaam seth salaam seth kuch apne layak kaam seth,***
***Aap to khaayen murgh musallam apni to bus rice plate.***
– Shaily Shailendra, Annu Mallik (now known as Anu Malik), Annu Mallik and Kawal Sharma, in *Jeete Hain Shaan Se* .

Corporates have reported bumper profits for the period July to September 2020.

This led a friend, who is generally unhappy with most of my writing given that he dabbles in the stock market which just keeps going up, to quip: " *How are the corporates making profits if the economy is not doing well?* "

This is an interesting question and needs to be addressed. Having said that, the right question to ask is, *how are the corporates making profits with the economy not doing well* .

Let's look at it pointwise.

**1)** A newsreport published in the Business Standard on November 17, 2020, considers the results of 2,672 listed companies, including their listed subsidiaries, for the period July to September 2020. During this period, the net profit of these companies touched a record Rs 1.52 lakh crore, up by 2.5 times in comparison to the same period in 2019.

**2)** There is a base effect at play here, with last year's low base making profits this year look very high. During the period July to September 2019, telecom companies faced massive losses. Their losses have come down during the period July to September 2020. Take the case of Vodafone Idea. The company reported a loss of Rs 50,000 crore last year. The loss during July to September 2020 was much lower at Rs 6,451 crore. Similarly for Airtel, the loss came down from around Rs 23,000 crore last year to Rs 776 crore this year.

These losses pulled down overall corporate profits by close to Rs 73,000 crore, during the period July to September 2019. This time around the losses of these two telecom companies were limited Rs 7,227 crore. Hence, these two companies had a *disproportionate negative impact* on the overall corporate profits last year. The same hasn't happened this year and in the process has ended up pushing up the overall corporate profit growth this year.

**3)** Interestingly, companies have managed to report an increase in net profit despite shrinking sales. The Business Standard report referred to earlier suggests that the net sales of these companies shrunk by 5.2% during July to September 2020. This is the fifth consecutive quarter when the sales of listed companies have shrunk. Depsite shrinking sales, profits have gone up.

**4)** Economist Mahesh Vyas of the Centre for Monitoring Indian Economy, looked at a sample of 1,675 listed manufacturing companies. He found that their combined net profit stood at Rs 72,600 crore, despite their net sales shirking by Rs 96,100 crore.

**5)** The question is how have companies managed to increase their net profit, despite doing less business than last year, leading to lower revenues. There are sectoral reasons at play. Thanks to the ongoing case in the Supreme Court, the banks did not have to report bad loans as bad loans. This has led to banks setting aside lesser money to meet the losses that may arise from these bad loans. This has clearly pushed up the profit number in the banking sector.

More specifically, the companies managed to cut more costs than they saw a fall in sales and thus pushed up their net profit.  Take the case of the manufacturing sector that Vyas has considered in his analysis, while their sales shrunk by Rs 91,600 crore, their operating expenses came down by Rs 1,33,100 crore or around Rs 1.33 lakh crore. The companies managed to drive down the cost of raw materials thanks to *a favourable shift in trade terms* and drawing down their inventories.

**6)** Other than driving down raw material cost, companies have also managed to cut down on employee costs. Economist Sajjid Chinoy of JP Morgan in a column in The Indian Express writes that net profit of companies went up despite shrinking revenues because "firms aggressively cut costs, including employee compensation." "Indeed, a sample of about 600 listed firms reveals employee costs (as a per cent of EBITDA) was the lowest in 10 quarters," he writes further.

A survey carried out by the Mint newspaper and Bain found that half of the companies had reduced employee costs by either firing employees or cutting their salaries.

The above points explain why corporate profits have gone up disproportionately despite shrinking revenues. Let's try and understand pointwise why this is not good for the Indian economy.

**1)** A major reason for raw material costs coming down is a favourable shift in trade terms. What does this mean? No company produces everything on its own. It uses inputs which are produced by other firms. In difficult times, companies are able to drive down the cost at which they purchase things from their suppliers, that is, inputs. The suppliers are other companies, which have  to drive down their costs as well, and this is how things are pushed down the hierarchy.

How do suppliers and suppliers to suppliers drive down their costs? They also try to shift the trade terms in their favour and at the same time cut employee costs, like companies have.

**2)** This leads to what economists call the *fallacy of composition* or what is good for one may not be good for many. A simple example of this is someone going to watch a cricket match. He stands up to get a better view of the game being played and he gets a better view. But then the person behind him also needs to stand up to get a better view. And so the story continues. In the end, everyone is standing and watching the match, instead of siting comfortably and enjoying it. To repeat, what is good for one, may not be good for many.

How does this apply in the current case? When companies cut down on input costs, they are obviously paying a lower amount of money to their suppliers or not buying new raw material or as much raw material as they did in the past, to increase their inventory.

By cutting down on employee costs, they are either paying a lower amount of money to their employees or simply firing them. The suppliers in turn have to cut their costs in order to continue to be profitable or lose a lower amount of money. So, the cycle continues and in the end leads to lower incomes for everyone involved.

**3)** This leads to what the economist John Maynard Keynes called the *paradox of thrift* . With incomes coming down, people spend a lower amount of money than they did before. It is worth remembering here that ultimately *one man's spending is another man's income* , leading to a further cut in spending. Even those who haven't seen a drop in their income or been fired, cut down on their spending. They are trying to save more, given the risk of them getting fired and not being able to find another job. This is the psychology of a recession and it is totally in place right now.

**4)** One of the ways of measuring the size of any economy or its gross domestic product (GDP), is to add the incomes of its different constituents. This means adding up rents, wages, interest and profits. While, profits of companies have been going up, individual wages have been going down, leading to lower spending and hence, lower private consumption. This explains why despite corporate profits of listed companies increasing at a fast pace, the GDP during the period July to September 2020, contracted by 7.54%.

**5)** An August 2019 report in the Business Standard said that the combined net profit of companies that make up for the BSE 500 index was at 2.31% of the GDP. Other studies suggest that this figure has constantly been coming down over the years. Despite the fact that listed companies form a small part of the Indian economy, their influence on the initial GDP figure is very high.

A large part of the Indian economy is informal. The measures representing this part of the economy cannot be generated quickly. In this scenario, the statisticians assume the informal economy to be a certain size of the formal one. Corporate profits are an important input into measuring the size of the formal economy. This is something that needs to be kept in mind while looking at the economic contraction of 7.54%. .

To conclude, while corporate profits going up is good news for the companies, there are many ifs and buts, that need to be taken into account as well, and on the whole the way these profits are being generated, it's not good news for the Indian economy.

Also, over a longer period, the only way to grow profits is by growing sales. This will start hitting the Indian corporates sooner rather than later.

7 December, 2020

# Mumbai Mirror Shutting Down and the Screwed Up Business Model of India Media

*Alibaba mil gaya chaalis choron se* – Anand Bakshi, Laxmikant-Pyarelal, Runa Laila, Aadesh Shrivastava and Mukul Anand, in *Agneepath* (1990).

There was a time when I bought and tried to read eight daily newspapers. Two things led to a change on this front. The first reason was very practical. Apartments in Mumbai are small and buying eight newspapers for six days a week (I took a break on Sundays), meant that the *raddi* accumulated very quickly and took up a lot of space.

The second reason was something I learnt from experience. Most news is just noise. Following noise helps if you are a news reporter because that is precisely your job. But if you are looking to understand the big picture and not miss the wood for the trees, as I was, it made sense to ignore most news that was published and train the mind to look at a few limited things which mattered. (Also, with the internet, one could always Google up the noise later, if the need arose).

This led to a massive cutdown in the newspaper buying habit. Also, around early 2007, I went fully digital, rarely buying physical copies. Hence, I have been reading e-papers now for close to fourteen years. Of course, unlike earlier, I seriously read only two newspapers (on most days) and sort of flip through a third one. And now one of the newspapers which I read seriously, Mumbai Mirror, is shutting down.

This development has made me take a look at the economics of the Indian media, newspapers and digital, in particular. TV news is an entirely different beast, which I do not understand well enough to be writing about. I will also look at the entire issue from the point of view of readers and try to explain why things have become very tricky.
Let's take a look at the issue pointwise.

**1)** Indian newspapers, the way they have evolved over the years, have totally become advertisement driven. Depending on who you ask, you are likely to be told that the split between advertisement revenue and subscription revenue, is 80:20 or 90:10, for that matter.

The point being that the readers are not consumers for newspapers, but the product, which is sold to corporates who advertise. Now in a post-corona world, the advertisements in newspapers have come down. Mumbai Mirror used to have an edition of 36 pages on most days before the covid pandemic struck. After covid, the size of the edition barely went beyond 16-18 pages on most days.

Clearly, the newspaper hadn't been getting enough advertisements, hence, the decision to shut it down. One can also speculate here that the sales of physical copies of newspapers have crashed post the pandemic and are nowhere near what they used to be (I mean newspapers in general here). That's one reason to possibly explain the lack of advertisements in Mumbai Mirror.
Also, the main reason behind setting up Mumbai Mirror doesn't exist anymore. The Times Group started the newspaper in 2005, to protect its prime brand, the Mumbai edition of The Times of India, from the Daily News and Analysis (DNA). The Mumbai edition of DNA was launched in July 2005. The other reason behind launching the Mumbai Mirror was to also protect Mumbai edition of The Times of India from The Hindustan Times, which launched a Mumbai edition in July 2005 as well.
DNA was shut down in October 2019, though the newspaper had been down in the dumps for close to a decade before that.

Given this, the Times Group, which looks at its publications not as news ventures but as *products which solicit advertising* , decided to cut down on its losses.

**2)** In the last couple of years, many media houses have put their epapers behind the paywall. Some media houses now offer only a certain number of articles per month free, beyond that the reader needs to subscribe (Honestly, there are very simple hacks available to get around this).

While, this might be a sensible thing to do, the chances of it working out quickly are very low. The Western newspapers which have been successful in raising a substantial portion of their revenues digitally, have been at it for almost two decades. Off the record conversations with a few higherups in the newspaper space tell me that digital doesn't bring in much money currently.

Also, a lot of the digital strategy of the Indian news media is all over the place. Like in the recent past, almost everybody has launched podcasts, without having the most basic infrastructure in place. The recordings of many of these podcasts are absolutely terrible (There are podcasts out there whose production values are superb as well, but that is more an exception which proves the rule). Of course, very few of these podcasts, like most of the digital media, earn any money. They have been launched because everyone else has also done so.

**3)** One of the theories that has been propounded in the recent past is that the media will survive and report the news that it should, only if the readers pay for the news they consume. Right now most news consumption is free. Honestly, I have subscribed to this theory as well at some point of time.

But now I am very sceptical of this argument. Let me offer a few reasons for the same. With corporate advertising taking a beating, the news media as a whole is now dependent on government advertising more than ever before. Revenues from the digital media cannot fill the gap because of the fall in corporate advertising.

Hence, the media as a whole needs to keep government(s) in good humour, so that the advertisements keep coming in. Also, other than this economic incentive, the other reason is simple political pressure and the fact that any government has a lot of nuisance value. The current central government thrives on projecting narratives which it wants to and for that it needs the so-called national media on its side. This will stop the media from covering news items like they should.

To cut a long story short, just because you, dear reader, have bought an annual digital subscription which cost Rs 1,000-2,500, it doesn't mean that the news media will start reporting news the way they should. *Propaganda and spin* will continue to be the order of the day.

**4)** Another phenomenon being seen is the rise of paid-newsletters. Some newsletters have achieved some scale and a few thousand paid subscribers. This is often offered as an example of how people are willing to pay for stuff which is written and presented well. While this is a good development, one needs to take into account the fact that the paid-newsletters are extremely niche with a large focus on the private equity, venture capital space, stock market investors etc.

At best they look at business and corporate stories. This doesn't fulfil the need for the media being *the fourth pillar in a democracy* . A few thousand people paying for some news they consume isn't going to help either the Indian media or the Indian democracy in any way, for that matter.

**5)** Another recent phenomenon has been that of out of work journalists starting their own newsletters and charging for it. While I have no specific idea of how well these newsletters are doing, I can tell you from my own experience that the point about at least 10% of your social media followers will end up paying for the newsletter, is a lot of bunkum. If you can get even 10% of your social media following to click on what you write, you will be doing a decent job of it, forget paying for the content.

**6)** Also, with newspapers and websites going behind a paywall, WhatsApp forwards and false news, will gain greater legitimacy as people will have easy access to them than genuine news.

As Alan Rusbridger writes in *Breaking News – The Remaking of Journalism and Why It Matters Now* : "Bad information [is] everywhere: good information [is] increasingly for smaller elites. It [is] harder for good information to compete on equal terms with bad."

It is very easy to put out bad information out there on the social media, after the fixed cost of a mobile phone or a cheap laptop and an internet connection has been met. The marginal cost after the fixed cost has been met, is almost zero. Politicians and political parties will continue to thrive on this.

**7)** Where does all this leave news-media houses? A basic point that MBAs who run these organisations haven't seem to have understood is that today's reader doesn't get his news from just one source like the old days, when most families subscribed to one newspaper or at best two newspapers and/or a weekly magazine.

Today's reader likes to read from multiple sources, basically whatever he finds interesting enough and/or whatever gets shared with him on WhatsApp or social media. Media houses clearly haven't caught up on this trend. They still want readers to make an upfront payment and commit to a subscription of at least one month.

It's time that they started adopting micro-payments and pricing their digital stories for as low as five bucks and let people pay for it, if it interests them. Other than offering people choice, this will allow news media houses to tackle the *subscription fatigue* that will set in sooner rather than later.

It is important to remember here that news media is competing not just with other news media, it is also competing with over the top (OTT) media platforms like Hotstar, Amazon Prime, Netflix, SonLiv etc., for a share of the consumer's wallet as well as his time and mind-space.

Other than Netflix, which is on the expensive side, the cost of subscribing to other OTTs is quite cheap. The news-media is competing with these OTT platforms as well.

**7)** Talking about competition, news media houses are now also competing with individual content creators, who have a strong presence on YouTube. Some of these content creators, who focus on delivering free as well as paywalled video content around the important news of the day and cut the clutter, have huge social media followings. Their business model rests around seeking donations from their followers. These donations can be as low as Rs 10. This makes another case for micropayments.

To conclude, common sense suggests that it will be easier to get people to pay for news digitally, if the amounts involved are small. As far as readers are concerned, there are no guarantees that they will get what they are looking for, even if they are ready to pay. One solution is to follow and support individuals like me who are trying to put out stuff they feel people should know about and which the mainstream media isn't writing about. Nevertheless, the problem there is that there is only so much an individual can do and it is very difficult for individuals to be consistent day and day out.

Disclosure: I worked for the Daily News and Analysis (DNA) between October 2005 and September 2010. I also worked for the Times Group between October 2010 and March 2012.

4 December, 2020

# Why RBI’s Monetary Policy Has Been a Bigger Flop Than Bombay Velvet


***Mere paas kothi hai na car sajni,***
***Kadka hai tera dildar sajni.***
— Rajkavi Inderjeet Singh Tulsi, Ravindra Jain, Kishore Kumar, Asha Bhonsle and Ashok Roy, in *Chor Machaye Shor* .

Okay, I didn’t have to wait for the Reserve Bank of India’s monetary policy declared today, to write this piece. I could have written this piece yesterday or even a month back. But then the news cycle ultimately determines the number of people who end up reading what I write, and one can’t possibly ignore that.

A few hours back, the Monetary Policy Statement was published by the RBI, after the monetary policy committee (MPC) met on 2nd, 3rd and 4th December. The MPC of the Reserve Bank of India (RBI) has the responsibility to set the repo rate, among other things. The repo rate is the interest rate at which the RBI lends to banks, and which to some extent determines the interest rates set by commercial banks for the economy as a whole.

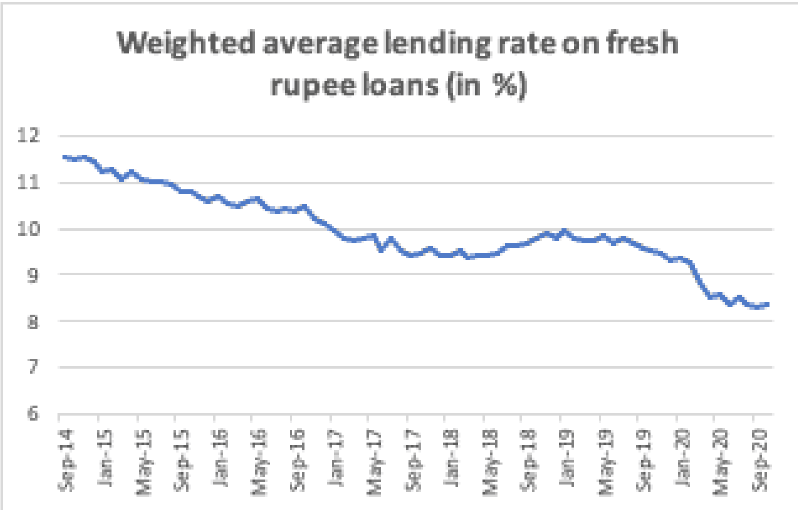
The MPC has been driving down the repo rate since January 2019, when the rate was at 6.5%. The rate had been cut to 5.15% by February 2020, around the time the covid pandemic struck.

By May 2020, the MPC had cut the repo rate further by 115 basis points to an all-time low of 4%. One basis point is one hundredth of a percentage. The idea behind the cut was two-fold.

In the aftermath of the covid pandemic as the economic activity crashed, the tax collections of the government crashed as well, leading to a situation where the government's borrowing requirement jumped from Rs 7.8 lakh crore to Rs 12 lakh crore.

The massive repo rate cut would help the government to borrow more at lower interest rates. The yield or the return on a ten-year government of India bond in early February was at 6.64%. Since then it has fallen to around 5.89% as of December 4. The government of India borrows by selling bonds. The money that it raises helps finance its fiscal deficit or the difference between what it earns and what it spends.

The second idea was to encourage people to borrow and spend more and businesses to borrow and expand, at lower interest rates. Take a look at the following chart. It plots the average interest at which banks have given out fresh loans over the years.




Source: Reserve Bank of India.

The data on average interest at which banks have given out fresh loans is available for a period of a little over six years, starting from September 2014 and up to October 2020. It can be seen from the above chart that the interest rates in the recent months, have been the lowest in many years. But has that led to an increase in lending by banks, that's the question that needs to be answered?

As of October 2020, the total outstanding non-food credit of banks by economic activity, had gone up by 5.6% in comparison to October 2019. Banks give loans to the Food Corporation of India and other state procurement agencies to buy rice, wheat and a few other agricultural products directly from farmers. Once we subtract these loans out from the overall loans given by banks that leaves us with non-food credit by economic activity.

Also, it needs to be mentioned here that this is how banking data is conventionally reported, in terms of the total outstanding loans of banks.

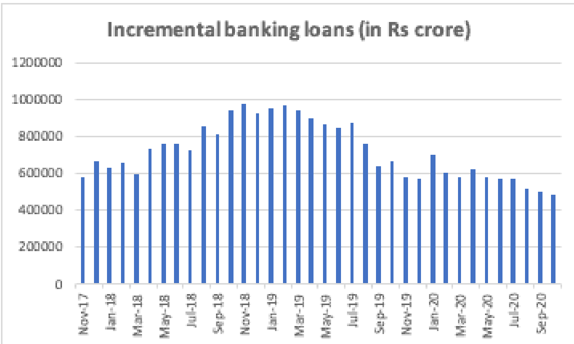
When you compare this with how other economic data is reported, it's different. Let's take the example of passenger cars.

When passenger car sales are reported, what is reported is the number of cars sold during a particular month and not the total number of cars running in India at that point of time. In case of banks, precisely the opposite thing happens.

What is conventionally reported is the total outstanding loans at any point of time and not the loans given incrementally during a particular period. So, the total outstanding non-food credit of Indian banks by economic activity, as of October end 2020 stood at Rs 92.13 lakh crore. This increased by 5.6% over October 2019.

The way this data is reported does not tell us the gravity of the situation that the banks are in. That comes out when we look at just incremental loans from one year back. The way to calculate this is to take total outstanding loans as of October 2020 and subtract that from outstanding loans of banks as of October 2019. The difference is incremental loans for October 2020. Similarly, the calculation can be done for other months as well.

Let's take a look incremental loans data over the last three years.

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As can be seen the above chart, the incremental loans every month in comparison to the same month last year, have been falling since late 2018, just a little before the RBI started cutting the repo rate. In October 2020, they stood at Rs 4.83 lakh crore, a three-year low.

What does this mean? It means that as the MPC of the RBI has gone about cutting the repo rate, the incremental loans given by banks have gone down as well. This is the exact opposite of what economists and central banks expect, that as interest rates fall, borrowing should go up.

And this has been happening from a time before the covid-pandemic struck. Covid has only accentuated this phenomenon. This also leads to the point I make often that for people to borrow more, just lower interest rates are not enough.

The main point that encourages people and businesses to borrow more is the confidence in their economic future. While the government will try and blame India's currently economic problems totally on covid, it is worth mentioning here that India's economic growth has seen a downward trend since March 2018. The economic growth for the period January to March 2018 had stood at 8.2% and has been falling since, leading to a lesser confidence in the economic future, both among individuals and corporates.

In fact, if we compare the situation between March 27, 2020, when covid first started spreading across India, and November 6, 2020, the total outstanding non-food credit of banks has grown by just Rs 2,221 crore (yes, you read that right, and this is not a calculation error).

During the same period, the total deposits of banks have grown by Rs 8.13 lakh crore or 6%. The incremental credit deposit ratio between March 27 and November 6, is just 0.27%. We can actually assume it be zero, given that it is so close to zero. Al these deposits have primarily been invested in government bonds.

Basically, on the whole, the banks have been unable to lend any of the deposits they have got from the beginning of this financial year. Only one part of banking is in operation. Banks are borrowing, they are not lending.

What does this tell us? It tells us that banking activity in the country has collapsed post covid, despite the RBI cutting the repo rate to an all-time low-level of 4%, where it's 361 basis points lower than the latest rate of retail inflation of 7.61%. Other than cutting the repo rate, the RBI has also printed a lot of money and pumped it into the financial system, to drive down interest rates.

But despite that people and businesses are not borrowing. RBI's monetary policy has been an even bigger flop than Anurag Kashyap's *Bombay Velvet* , Raj Kapoor's *Mera Naam Joker* and Satish Kaushik's *Roop ki Rani Choron ka Raja* . (I name three different films so that readers of different generations all get the point I am trying to make here).

In the monetary policy statement released a few hours back, there is very little mention of this, other than:

> *"A noteworthy development is that non-food credit growth accelerated and moved into positive territory for the first time in November 2020 on a financial year basis ."*

The governor's statement has some general *gyan* like this:

> *"In response to the COVID-19 pandemic, the Reserve Bank has focused on resolution of stress among borrowers, and facilitating credit flow to the economy, while ensuring financial stability."*

No explanations have been offered on why the monetary policy has flopped. The current dispensation at India's central bank is getting used to behaving like the current government.

It is important to understand here why monetary policy has been such a colossal flop this year. The answer lies in what the British economist John Maynard Keynes called *the paradox of thrift* . When a single individual saves more, it makes sense, as he prepares himself to face an emergency where he might need that money.

But when the society as a whole saves more, as it currently is, that causes a lot of damage because one's man spending is another man's income. As we have seen bank deposits during this financial year have gone up Rs 8.13 lakh crore or 6%. On the whole, people are cutting down on their spending and saving more for a rainy day.

The psychology of a recession at play and not just among those people who have been fired from their jobs or seen a fall in their income. It is obvious that such people are cutting down on their spending. But even those who haven't faced any economic trouble are doing so.

They are doing so in the fear of seeing a fall in their income or losing their job and not being able to find a new one. When the individuals are cutting down on their spending, it doesn't make much sense for businesses to borrow and expand. In fact, the overall bank lending to the industry sector has contracted by Rs 4,624 crore between October 2019 and October 2020.

Typically, in a situation like this, when the private sector is not in a position to spend, the government of the day steps in. The trouble is that the current government is not in a position to do so as tax revenues have collapsed this year. There other fears at play here as well.

In the midst of all this, Dinesh Khara, the chairman of the State Bank of India told the Business Standard, that bank lending rates "have actually bottomed". Given that banks have barely lent anything this year, it makes me sincerely wonder what Mr Khara has been smoking. Clearly, it makes sense to avoid that.

To conclude, monetary policy should not get the kind of attention it gets in the business media, simply because, it is dead, and it has been dying for a while. The trouble is, there are one too many banking correspondents and even more central bank watchers, including me, who need to make a living.

And very few among us, are likely to ask the most basic question— *why monetary policy is not working* .

***Le jayenge le jayenge dilwale dulhaniya le jayenge***
— Rajkavi Inderjeet Singh Tulsi, Ravindra Jain, Kishore Kumar, Asha Bhonsle and Ashok Roy, in *Chor Machaye Shor* .

1 December, 2020

# 13 Reasons RBI Shouldn’t Allow Large Corporates/Industrial Houses to Own Banks

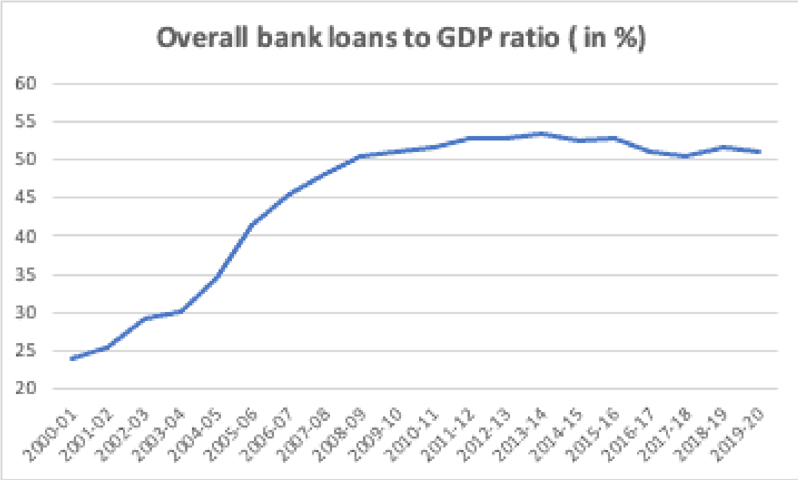

***Apna hi ghar phoonk rahe hain kaisa inquilab hai.***

— Hasrat Jaipuri, Mohammed Rafi, Mukhesh, Ravindra Jain and Naresh Kumar, in *Do Jasoos* .

Should large corporates/industrial groups be allowed to own banks? An internal working group (IWG) of the Reserve Bank of India (RBI), thinks so. I had dwelled on this issue sometime last week, but that was a very basic piece. In this piece I try and get into some detail.

The basic point on why large corporates/industrial groups should be allowed into banking is that India has a low credit to gross domestic product (GDP) ratio, which means that given the size of the Indian economy, the Indian banks haven’t given out enough loans. Hence, if we allow corporates to own and run banks, there will be more competition and in the process higher lending. QED.

Let’s take a look at the following chart, it plots the overall bank lending to GDP ratio, over the years.




Source: Centre for Monitoring Indian Economy.

The above chart makes for a very interesting read. The bank lending grew from 2000-01 onwards. It peaked at 53.36% of the Indian GDP in 2013-2014. In 2019-20 it stood at 50.99% of the GDP, more or less similar to where it was in 2009-10, a decade back, at 50.97% of the GDP. Hence, the argument that lending by Indian banks has been stagnant over the years is true.

*But will more banks lead to more lending?* Since 2013, two new universal banks, seven new payment banks and ten new small finance banks have been opened up. But as the above chart shows, the total bank loans to GDP ratio has actually come down.

Clearly, the logic that more banks lead to more lending is on shaky ground. There are too many other factors at work, from whether banks are in a position and the mood to lend, to whether people and businesses are in the mood to borrow. Also, the bad loans situation of banks matters quite a lot.

In fact, even if we were to buy this argument, it means that the Indian economy needs more banks and not necessarily banks owned by large corporates/industrial houses, who have other business interests going around.

Also, the banks haven't done a good job of lending this money out. As of March 2018, the bad loans of Indian banks, or loans which had been defaulted on for a period of 90 days or more, had stood at 11.6%. So, close to Rs 12 of every Rs 100 of loans lent out by Indian banks had been defaulted on. In case of government owned public sector banks, the bad loans rate had stood at 15.6%. Further, when it came to loans to industry, the bad loans rate of banks had stood at 22.8%.

Clearly, banks had made a mess of their lending. The situation has *slightly improved* since March 2018. The bad loans rate of Indian banks as of March 2020 came down to 8.5%. The bad loans rate of public sector banks had fallen to 11.3%.

The major reason for this lies in the fact that once a bad loan has been on the books of a bank for a period of four years, 100% of this loan has been provisioned for. This means that the bank has set aside an amount of money equal to the defaulted loan amount, which is adequate to face the losses arising out of the default. Such loans can then be dropped out of the balance sheet of the banks. This is the main reason behind why bad loans have come down and not a major increase in recoveries.

This is a point that needs to be kept in mind before the argument that large corporates/industrial houses should be given a bank license, is made.

There are many other reasons why large corporates/industrial houses should not be given bank licenses. Let's take a look at them one by one.

**1)** The IWG constituted by the RBI spoke to many experts. These included four former deputy governors of the RBI, Shyamala Gopinath, Usha Thorat, Anand Sinha and N. S. Vishwanathan. It also spoke to Bahram Vakil (Partner, AZB & Partners), Abizer Diwanji (Partner and National Leader – Financial Services EY India), Sanjay Nayar (CEO, KKR India), Uday Kotak (MD & CEO, Kotak Mahindra Bank.), Chandra Shekhar Ghosh (MD & CEO, Bandhan Bank) and PN Vasudevan (MD & CEO, Equitas Small Finance Bank).

Of these experts only one suggested that large corporates/industrial houses should be allowed to set up banks. The main reason behind this was "the corporate houses may either provide undue credit to their own businesses or may favour lending to their close business associates". This is one of the big risks of allowing a large corporate/industrial house to run a bank.

**2)** As the Report of the Committee on Financial Sector Reforms (2009) had clearly said:

> *"The selling of banks to industrial houses has been problematic across the world from the perspective of financial stability because of the propensity of the houses to milk banks for 'self-loans' [emphasis added]. Without a substantial improvement in the ability of the Indian system to curb related party transactions, and to close down failing banks, this could be a recipe for financial disaster."*

While, the above report is a decade old, nothing has changed at the ground level to question the logic being offered. Combining banking and big businesses remains a bad idea.

**3)** Let's do a small thought experiment here. One of the reasons why the government owned public sector banks have ended up with a lot of bad loans is because of crony capitalism. When a politician or a bureaucrat or someone higher up in the bank hierarchy, pushes a banker to give a loan to a favoured corporate, the banker isn't really in a position to say no, without having to face extremely negative consequences for the same.

Along similar lines, if a banker working for a bank owned by a large corporate or an industrial house, gets a call from someone higher up in the hierarchy to give out a loan to a friend of a *maalik* or to a company owned by the *maalik* , will he really be in a position to say no? His incentive won't be very different from that of a public sector banker.

**4)** As Raghuram Rajan and Viral Acharya point out in a note critiquing the entire idea of large corporates/industrial houses owning banks: "Easy access to financing via an in-house bank will further exacerbate the concentration of economic power in certain business houses." This is something that India has had to face before.

As the RBI Report of Currency and Finance 2006-08 points out:

> *"The issue of combining banking and commerce in the banking sector needs to be viewed in the historical perspective as also in the light of crosscountry experiences. India's experience with banks before nationalisation of banks in 1969 as well as the experiences of several other countries suggest that several risk arise in combining banking and commerce. In fact, one of the main reasons for nationalisation of banks in 1969 and 1980 was that banks controlled by industrial houses led to diversion of public deposits as loans to their own companies and not to the public, leading to concentration of wealth in the hands of the promoters. Many other countries also had similar experiences with the banks operated by industrial houses."*

This risk is even more significant now given that many industrial houses are down in the dumps thanks to over borrowing and not being able to repay bank loans. Hence, the concentration of economic power will be higher given that few industrial houses have their financial side in order, and they are the ones who will be lining up to start banks.

**5)** Another argument offered here has been that the RBI will regulate bank loans and hence, self-loans won't happen. Again, this is an assumption that can easily be questioned. As the RBI Report of Currency and Finance 2006-08 points out: "The regulators temper the risk taking incentives of banks by monitoring and through formal examinations, this supervisory task is rendered more difficult when banking and commerce are combined."

This is the RBI itself saying that keeping track of what banks are up to is never easy and it will be even more difficult in case of a bank owned by a big business.

**6)** The ability of Indian entrepreneurs to move money through *a web of companies* is legendary. In this scenario, the chances are that the RBI will find out about self-loans only after they have been made. And in that scenario there is nothing much it will be able to do, given that corporates have political connections and that will mean that the RBI will have to look the other way.

**7)** There are other *accounting shenanigans* which can happen as well. As the RBI Report of Currency and Finance cited earlier points out:

> *"Bank can also channel cheaper funds from the central bank to the commercial firm. On the other hand, bad assets from the commercial affiliate could be shifted to the*

> *bank either by buying assets of the firms at inflated price or lending money at below-market rates in order to effect capital infusion."*

Basically, the financial troubles of a large corporate/industrial house owning a bank can be moved to the books of the bank that it owns.

**8)** If we look at the past performance of the RBI, there wasn't much it could do to stop banks from bad lending and from accumulating bad loans.  This is very clear from the way the RBI acted between 2008 and 2015. Public sector banks went about giving out many industrial loans, which they shouldn't have, between 2008 and 2011. The RBI couldn't stop them from giving out these loans. It could only force them to recognise these bad loans as bad loans, post mid-2015 onwards, and stop them from kicking the bad loans can down the road. So, the entire argument that the RBI will prevent a bank owned by a large corporate/industrial house from giving out self-loans, is on shaky ground.


**9)** Also, it is worth remembering that the RBI cannot let a bank fail. This creates *a huge moral hazard* when it comes to a bank owned by a large corporate/industrial house. What does this really mean? Before we understand this, let's first try and understand what a moral hazard means.

As Alan S Blinder, a former vice-chairman of the Federal Reserve of the United States, writes in *After the Music Stopped* : "The central idea behind moral hazard is that people who are well insured against some risk are less likely to take pains ( and incur costs) to avoid it. Here are some common non financial examples: …people who are well insured against fire may not install expensive sprinkler systems; people driving cars with more safety devices may drive less carefully."

In the case of a large corporate/industrial house owned bank, the bank knows that the RBI cannot let a bank fail. This gives such a bank an incentive to take on greater risks, which isn't good for the stability of the financial system.

As the Currency Report points out:

> *"The greatest source of risk from combining banking and commerce arises from the threat to the safety net provided under the deposit insurance and 'too-big-to-fail' institutions whose depositors are provided total insurance and the mis-channeling of resources through the subsidised central bank lending to banks. Because of the safety net provided, the firms affiliated with banks could take more risk with depositors' money, which could be all the more for large institutions on which there is an implicit guarantee [emphasis added] from the authorities."*

Other than *incentivising the other firms* owned by the same large corporates/industrial houses to take on more risk in its activities, it also means that now the RBI other than keeping track of banks, will also need to keep track of the economic activities of these other firms. *Does the RBI have the capacity and the capability to do so?*

**10)** Another argument offered in favour of large corporates/industrial houses owning banks is that they already own large NBFCs. So, what is the problem with them owning banks? The problem lies in the fact that banks have access to a safety net which the NBFCs don't. RBI will not let a bank fail and will act quickly to solve the problem. And that is the basic difference between a large corporate/industrial house owning a bank and owning an NBFC. Also, the arguments that apply to large corporates/industrial houses owning a bank are equally valid in case of them owning NBFCs, irrespective of the fact that large corporates already own NBFCs. Two wrongs don't make a right.

**11)** We also need to take into account the fact many countries including the United States, which has much better corporate governance than India, don't allow the mixing of commerce and business. As the Report of the Committee on Financial Sector Reforms (2009) had pointed out: "This prohibition on the 'banking and commerce' combine still exists in the United States today, and is certainly necessary in India till private governance and regulatory capacity improve."

The interesting thing is that in the United States, the separation between banking and commerce has been followed since 1787.

As the Currency Report points out:

> *"Banks have frequently tried to engage in commercial activities, and commercial firms have often attempted to gain control of banks. However, federal and state legislators have repeatedly passed laws to separate banking and commerce, whenever it appeared that either (i) the involvement of banks in commercial activities threatened their safety and soundness; or (ii) commercial firms were acquiring a large numbers of banks."*

Also, anyone who has studied the South East Asian financial crisis of the late 1990s would know that one of the reasons behind the crisis was allowing large corporates to own banks.

**12)** This is a slightly technical point but still needs to be made. Banks by their very definition are highly leveraged, which basically means the banking business involves borrowing a lot of money against a very small amount of capital/equity invested in the business. The leverage can be even more than 10:1, meaning that the banks can end up borrowing more than Rs 100 to go about their business, against an invested capital of Rs 10.

On the flip side, the large corporates/industrial houses have concentrated business interests or business interests which are not very well-diversified. Hence, trouble in the main business of a large corporate can easily spill over to their bank, given the lack of diversification and high leverage. This is another reason on why they should not be allowed to run banks.

**13)** As Raghuram Rajan and Viral Acharya wrote in their recent note: "One possibility is that the government wants to expand the set of bidders when it finally sets to privatizing some of our public sector banks."

This makes sense especially if one takes into account the fact that in recent past the government has been promoting *the narrative of atmanirbharta* .

In this environment they definitely wouldn't want to sell the public sector banks to foreign banks, who are actually in a position to pay top dollar. Hence, the need for banks owned by large corporates/industrial houses looking to expand quickly and willing to pay good money for a bank already in existence.

Given this, the government wants banks owned by large corporates/industrial houses in the banking space, so that it is able to sell out several dud public sector banks at a good price. But then this as explained comes with its own set of risks.

To conclude, the conspiracy theory is that all this is being done to favour certain corporates close to the current political dispensation. And once they are given the license, this window will be closed again. Is that the case? On that your guess is as good as mine. Nevertheless, if this is pushed through, someone somewhere will have to bear the cost of this decision.

As I often say, there is no free lunch in economics, just that sometimes the person paying for the lunch doesn't know about it.

***Aa gaya aa gaya halwa waala aa gaya, aa gaya aa gaya halwa waala aa gaya***

— Anjaan, Vijay Benedict, Sarika Kapoor, Uttara Kelkar, Bappi Lahiri and B Subhash (better known as Babbar Subhash), in *Dance Dance.*

30 November, 2020

# Why Large Economies Are In a Technical Recession

Almost all large economies in the world, other than China, are in the midst of a technical recession, with their gross domestic product (GDP) having contracted for two or more quarters. On Friday, India became the latest large economy to enter this list. The spread of the covid pandemic and a big fear of a possible second wave, have led to consumers and businesses being very careful in the way they spend their money and saving for a possible rainy day.

### What is a technical recession?

When the GDP of any economy contracts for two consecutive quarters, economists refer to the situation as a technical recession. GDP is a measure of economic activity and size of a country. Let’s take the case of the United States. The GDP contracted by 9% between April and June 2020 in comparison with the same period in 2019. It contracted again by 2.9% between July and September 2020. So, as of end September, the American economy was in a technical recession.

If we consider the United Kingdom, the economy has contracted in each of the periods between January to March, April to June and July to September, by 2.1%, 21.5% and 9.6%, respectively. Hence, the country has been in a technical recession since the end of June. The only exception to this has been China, which has grown by 3.2% and 4.9%, respectively, between April and June and July and September.

### How is a technical recession different from a recession?

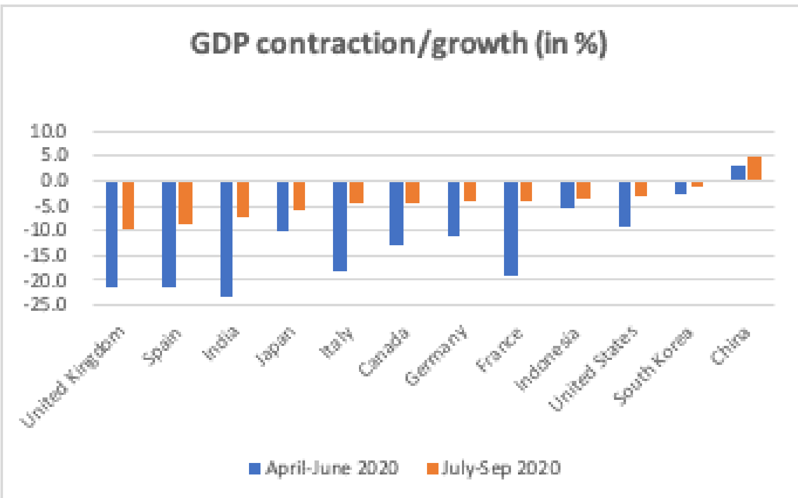
An economic scenario where the economy of a country has been contracting for a long period of time, is referred to as a recession. The trouble is there is no standard definition for how long is long. The National Bureau of Economic Research in the United States defines a recession as “a significant decline in economic activity that is spread across the economy and lasts more than a few months”.

Hence, if the current decline in economic activity across countries continues in the months to come, then we can safely say that we are in the midst of a recession. The spread of covid has led to economic activity slowing down. Businesses in order to continue to exist have slashed salaries and/or fired people. Even those who haven’t been fired live with the fear of getting fired. All this has led to a slowdown in people and businesses spending money.

### When was the last time the world was in a recession?

Lehman Brothers, the fourth biggest investment bank on Wall Street, went bust in mid-September 2008. Many other financial institutions came under huge financial stress and had to be rescued by the governments and the central banks of the United States and Europe. The trouble spilled from Wall Street to Main Street and a recession hit the Western economies.

The central banks in the Western world printed a huge amount of money to drive down interest rates, in the hope that people will borrow and spend, and businesses will borrow and expand. A lot of this money found its way into stock markets all across the world. The interesting thing is that even in 2020 the central banks are using the same formula. They have printed a lot of money to revive economies. The Federal Reserve of the United States has printed more than $3 trillion between end of February and now.




### When did India enter a technical recession?

The Indian economy had contracted by 23.9% during the period April to July. This was the largest contraction among all large economies of the world. It contracted again by 7.5%, between July to September, thus entering a technical recession. Hence, as of end September the Indian economy has been in the midst of a technical recession.

Why has this happened? Private consumption, or the stuff that people buy, and which forms more than half of the Indian GDP, has completely collapsed. Between April and June, it contracted by 26.7%. It contracted by 11.3%, between July and September. As mentioned earlier, this is primarily because of people saving more for a rainy day. This can be gauged from the fact that deposits in the Indian banking system have gone up 6% or Rs 8.1 trillion between end of March, when covid first started to spread in the country, and now.

**How can the world get out of this economic mess?**

The British economist John Maynard Keynes had a term for a situation like this – the paradox of thrift. When a society as a whole saves substantially more, it hurts the economy, simply because one man's spending is another man's income. Hence, in recessionary times, when individuals and businesses are spending less money, the government needs to chip in and spend more money than it usually would have.

This spending puts more money in hands of people. And if they go out there and spend it, it helps in economic revival. The trouble is that thanks to a recessionary environment, tax collections have collapsed. Some governments have resorted to printing more money to finance extra expenditure and hoping to create growth. But not every country has this option because money printing can lead to higher prices or inflation, as a greater amount of money chases the same set of goods and services.

This piece originally appeared in the *Khaleej Times* on November 30, 2020.

28 November, 2020

# What a Mumbai Real Estate Agent Can Tell You About Indian Economy Contracting


***Koi yahan aaha naache naache,***
***Koi wahan aahe naache naache.***

— Usha Uthup, Faruk Kaiser, Bappi Lahiri and Babbar Subhash (better known as B Subhash), in the *Disco Dancer .*

The gross domestic product (GDP) figures for the period July to September 2020 were published yesterday. The GDP is a measure of the economic size of a country during a particular period. The Indian GDP or the economic size of the country during the period contracted by 7.54% against the same period last year.

This looks very good in comparison to the contraction of 23.92% that the economy had seen during the period April to June 2020 and has led to the *uncorking of the bubbly* among a certain set of politicians, economists, analysts, journalists, stock market wallahs and Twitter warriors.

Of course, there is no denying that a contraction of 7.54% is a lot better than a contraction of 23.92%, one would be a fool to deny that. But has the time to uncork the bubbly come? Or, if you are not the drinking type, should we be high-fiving on this one?

Let's take a look at this pointwise.

**1)** For much of the period between April to June, the economy was under a lockdown. Once the economy was opened up, things were bound to improve. Hence, a better performance in July to September should not come as a surprise. Second, the period benefitted because of a lot of pent up demand. People who could not buy the stuff they wanted to during April to June, ended up buying it between July to September. These points need to be kept in mind.

**2)** The economists were expecting a contraction of 8.5-9% during the quarter. Against that a contraction of 7.54% looks just about a little better. Having said that, India has a large unorganised sector. Measuring the value added by the unorganised sector is never easy. Hence, when releasing GDP data for a period of three months for the first time, the National Statistical Office (NSO) essentially proxies the value added by the informal sector using formal sector data. This is set right as data streams in over a period of time.

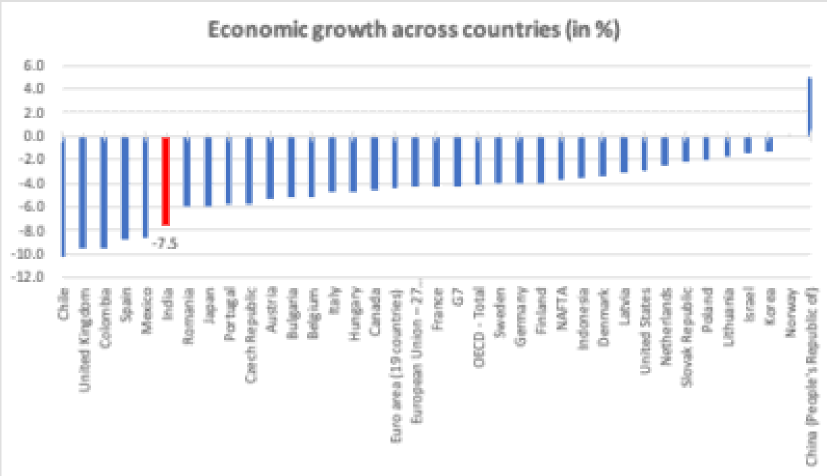
Over and above this, we are in midst of a pandemic and hence, collection of data isn't easy. As the NSO points in its release: "Some other data sources such as GST, interactions with professional bodies etc. were also referred to for corroborative evidence and these were clearly limited."

What this means is that the GDP data presents a picture which is rosier than the actual picture.

**3)** There is another important point that needs to be made here. India has been publishing quarterly GDP for close to 24 years now. This is only the second time in all these years that the GDP during a particular period of three months has contracted. Only twice in 94 quarters has the economy contracted. And given that GDP has contracted in two consecutive quarters, India is in a midst of what economists call a *technical recession* . If the economy continues to contract in the months to come, it will enter a recession. That's the difference between a recession and a technical recession.


Source: Centre for Monitoring Indian Economy.

**4)** In the period April to June with a contraction of 23.92%, India was the worst performing economy among the major economies in the world. From the data that is currently available on the OECD website, India is no longer the worst performing economy in the world, nonetheless, it continues to be among the worst performing economies in the world.




Source: https://stats.oecd.org/index.aspx?queryid=350

**5)** A major surprise in the GDP data has been the recovery of the manufacturing sector. The sector grew by 0.62%, after contracting (or degrowing as analysts like to say) by 39.30% between April to June. While this is good news, it goes against the fact that index of industrial production contracted by 6.09% during July to September. If the production has contracted how has the growth come about? The growth has come primarily from the fact that companies in the listed space have been able to increase their profit margins primarily because of controlling costs, this includes firing employees and slashing their salaries.
As economist Mahesh Vyas recently wrote in a column: "In the September 2020 quarter, while sales fell again by 9.7 per cent, profits sprang a surprise by scaling up by a handsome 17.8 per cent. Yet, wages declined by one per cent. Evidently, companies do not apportion resources to labour in any proportion of profits."

**6)** Sectors like construction, mining as well as services continued to remain weak, though better than they were during April to June. These sectors are high employment sectors. This remains a worry given that what seems to be happening currently is a recovery which isn't creating enough jobs. In fact, financial services, real estate and professional services (bundled together for some reason in the GDP data) contracted by 8.09% during July to September. It had contracted by 5.33% during April to June. And that can't possibly be a good thing. This can also be seen under NREGA data where demand for jobs this year remains astonishingly higher than last year. It can also be seen in the labour participation rate contracting with people stopping to look for jobs because they are unable to find one, and hence, dropping out of the workforce.

It also needs to be said here if there is a second round of covid, as is being feared, the services sector will continue to remain weak, in particular services like restaurants, hotels, tourism, cinema halls, malls etc.

**7)** If we look at GDP from the expenditure side, the private consumption expenditure contracted by 11.32% against a contraction of 26.68% between April to June. Clearly, there has been improvement on this front. Nevertheless, private consumption expenditure forms more than half of the Indian economy, and as long as it continues to remain weak, the economy will continue to remain weak. Also, we need to remember that the contraction of 11.32% happened despite pent up demand and festivals in the Western and Southern part of the country. Further, the fact that private consumption has continued to contract, brings into question the growth in the manufacturing sector. Are actual sales happening at the consumer level or is this simply a case of a build-up of inventory, as has been the case in the auto industry?

**8)** This is a slightly technical point but still needs to be made. On the expenditure side, the GDP is calculated as a sum of private consumption expenditure, investment, government expenditure and net exports. Net exports is exports minus imports. In the Indian case, this is a negative entry into the GDP figure, given that exports are usually less than imports. During July to September, net exports is a positive number, given that imports are lower than exports, having fallen by a much higher rate. This is primarily because of a collapse in consumer demand, which is not a good thing. When it comes to the goods part of imports, the non-oil non-gold non-silver part of imports collapsed by 23.82% during July to September. This helped push up the GDP number.

**9)** The GDP has contracted by 15.67% during the first six months of the year. If the economy contracts by 3-5% during the second half of the year, we *still* are looking at 9-10% contraction this year. This was largely the consensus forecast made for this year. Even if there is no contraction in the second half of the year, the economy will still contract 7.66%, which will make India one of the worst performing economies in 2020-21. Also, we need to remember that the GDP of 2019-20 is likely to be crossed now only in late 2021-22 or 2022-23. So this pushes the Indian economy back by at least two years. Of course a lot of it is because of covid, but let's not forget, the Indian economy had been slowing down even before the pandemic struck.

**10)** Let me close this piece with a little story. Sometime in April 2006, I first started to look for a flat to rent, in Mumbai. Of course, one had to go through agents. Pretty soon, I realised that the agents were trying a psychological trick on me. They first showed me a flat which was in a very bad state. They would then show me something which was slightly better. Nevertheless, the difference in rent between the flat was much more than the difference in their quality, with the rent of the second flat being much more than the first one. I caught on to this because I had read this book called *Freakonomics* sometime in 2005. The book had an extended chapter on the contrast effect.

We all tend to compare things before making a decision. Given this, the attraction of an option can be increased significantly by comparing it to a similar, but worse alternative. This is known as the 'contrast effect'.

How does this apply in the present context? It's simple. The fact that the Indian economy contracted by a massive 23.92% during April to June, it makes a contraction of 7.54% during July to September, much better. But there are many nuances, as explained above, that need to be taken into account.

PS: My writing has been highly irregular over the last few weeks. I was busy with a project I had taken on. Now that I am done with it, will write more regularly.

23 November, 2020

# Why Large Corporates/Industrial Houses Owning Banks is a Bad Idea


An internal working group (IWG) of the Reserve Bank of India (RBI) has suggested that large corporate/industrial houses may be allowed to promote banks. Does this huge leap of faith being made by the Indian central bank, given their current extremely cautious and conservative approach, make sense? Let's try and understand.

### Why should large corporates be allowed into banking?

The IWG feels that allowing large corporates to promote banks can be an important source of capital. In a capital starved country like India this makes sense. Further, these corporates can bring "experience, management expertise, and strategic direction to banking".

The group also noted that internationally "there are very few jurisdictions which explicitly disallow large corporate houses". All these reasons make sense, but there are major reasons as to why the RBI in the last five decades hasn't let large corporates enter the banking sector in India. At the heart of all this is the conflict of interest it would create.

### Why have large corporates not been allowed into banking?

The IWG spoke to experts on the issue: "All the experts except one [said] that large corporate/industrial houses should not be allowed to promote a bank." The corporate governance in Indian companies isn't up to international standards and "it will be difficult to ring fence the non-financial activities of the promoters."

There will be a risk of promoters giving loans to themselves. Before bank nationalisation in 1969, some of the private banks were owned by large corporates. As Professor Amol Agrawal of Ahmedabad University puts it: " *Since the private banks were run by big industrialists, they gave loans to themselves* ."

## What does history have to say in this regard?

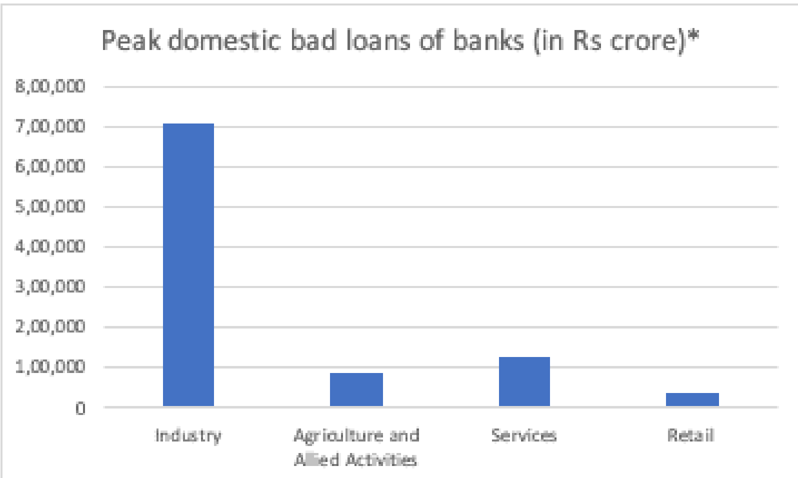
As Pai Panandikar, an Advisor in the Finance Ministry, wrote in August 1967, regarding these banks : "Internal procedures… vest large discretionary powers in the Boards of Directors who have often acted as sources of patronage in deciding credit matters."

A survey showed that 188 individuals served as directors on boards of 20 leading banks and held 1452 directorships of other companies. These individuals had directorships in 1100 companies.

## What did these large discretionary powers lead to?

In an October 1967 report commissioned by politician Chandrashekhar, then the Secretary of the Congress Party, it was found that of the total bank loans of Rs 2,432 crore in 1966, Rs 292 crores was the debt due from the bank directors and their companies.

In fact, if indirect loans and advances were included, *the actual debt-linked to directors was Rs 600-700 crore* . There is a danger of something similar happening even now given the weak corporate governance structures.




*As of March 31, 2018.

Source: Rajya Sabha Unstarred Question No: 1492, Answered on 18 July 2018.

## What does this mean in the current scheme of things?

As of March 2018, the domestic bad loans of Indian banks peaked at Rs 9.62 lakh crore. Of this, around 73.2% or Rs 7.04 lakh crore, were defaults made by industry.

The corporates have been responsible for a bulk of the mess in the Indian banking sector. Given that, *handing over banking licenses to them is not a sensible idea* , especially when the ability of banks to recover bad loans is limited.

22 November, 2020

# High Inflation In Times of Covid Will Hit Us Hard


In October 2020, inflation as measured by the consumer price index stood at 7.61%. *This is the highest inflation experienced during the period Narendra Modi has been prime minister.* The last time inflation or the rate of price rise, was higher than this, was in March 2014, when it had stood at 7.63%.

Let's look at this issue pointwise.

**1)** A major reason for high inflation has been high food inflation which was at 11.07% in October. Food forms around 39% of the weight of the consumer price index. Within food, prices of egg, fish and meat, oils and fats, vegetables, pulses and spices, went up by more than 10%.

Interestingly, potato prices are 104.56% higher since last October. This is the highest inflation among all the items which are a part of the consumer price index. One reason offered for this has been a disruption in supply chains due to the spread of covid. But the economy has now more or less totally opened up, meaning disruption can't continue to be a valid reason. Also, food inflation has been on the higher side since October last year, much before covid broke out.

**2)** The high inflation is not just because of high food inflation. If we look at core inflation, which leaves out food items and fuel and light items, the inflation is at 5.64%, the highest in thirty months. A major reason for this has been an increase in transport and communication costs which went up by 11.16% in October.

Fares of buses, taxies, auto-rickshaws and rickshaws, have gone up. This is because petrol and diesel are now more expensive than they were last year. The government has increased the excise duty on both the fuels, despite the fact oil prices have fallen internationally. The government's dependence on fuel taxes has only gone up this year and which is now reflecting in a higher inflation as well. Petrol and diesel used for vehicles come under the transport and communication category of the consumer price index and not the fuel category.

**3)** Another reason for high core inflation is the higher inflation in the pan, intoxicants and tobacco segment. Interestingly, foreign liquor and beer cost 22.32% and 25.32% more this year than last year. This reflects the state governments increasing the tax on these products in order to shore up revenue.

Toddy prices have also risen 20.19%. Also, the personal care and effects segment saw an inflation of 12.07% in October. The cost of going to a barber/beautician went up by 7.04%. But the major increase here has been in the prices of gold, silver and other ornaments, which went up by 33.77%, 36.66% and 20.52%, respectively. For some reason, they are categorised under personal care and effects.

**4)** While inflation in the health category has been lower this year than the last year, in October it went up by 5.22%, the highest it has been this year.

**5)** Within the fuel category, the price of domestic cooking gas went up by 10.16% in October, while non-PDS kerosene was up 8.28%.

**6)** The high inflation is primarily in the areas of food, parts of fuel, communication and to some extent, health. These are areas which impact the common man. How do higher prices of gold, silver and other ornaments impact the common man? They play a very important role in Indian marriages.

All in all, high inflation has hit India at a time when the country has just gone through its first ever recession after independence. The Indian economy contracted by 23.9% during April to June. It is expected to contract between July and September as well. A recession is defined as a period when the economy contracts for two consecutive quarters.

In fact, as Nikhil Gupta and Yaswi Agarwal of the stock brokerage Motilal Oswal point out in a recent research note: "The rise in the core inflation in India is also the highest among the 21 major economies in the world." Indeed, this is very worrying.

**7)** High inflation has hit us at a time when an economic contraction has led to a fall in incomes. Over and above this, people are also saving more to be ready for a rainy day. The total amount of bank savings have increased by Rs 6.32 lakh crore between March 27, around the time the country first started to realise how dangerous covid could be, and October 23. Last year, during a similar period, the deposits had gone up by Rs 3.29 lakh crore. The psychology of a recession is totally in place.

What does this mean? A good segment of the population has been cutting down on their consumption, particularly non-essential consumption, thanks to lower incomes. A high rate of inflation, if it prevails, will only add to people cutting down on consumption further, making the job of the government and the Reserve Bank of India (RBI) to get the economy going even more difficult.

**8)** While deposits with banks have soared, the total amount of loans given by banks has actually contracted by a little over Rs 32,000 crore between March 27 and October 23. On the whole, banks haven't given a single rupee of a new loan, since covid struck.

This has led to the RBI cutting the repo rate or the rate at which it lends to banks. Along with this, the central bank has printed and pumped a lot of money into the financial system, in the hope of driving down interest rates, in order to get both companies and individuals to borrow and spend more money.

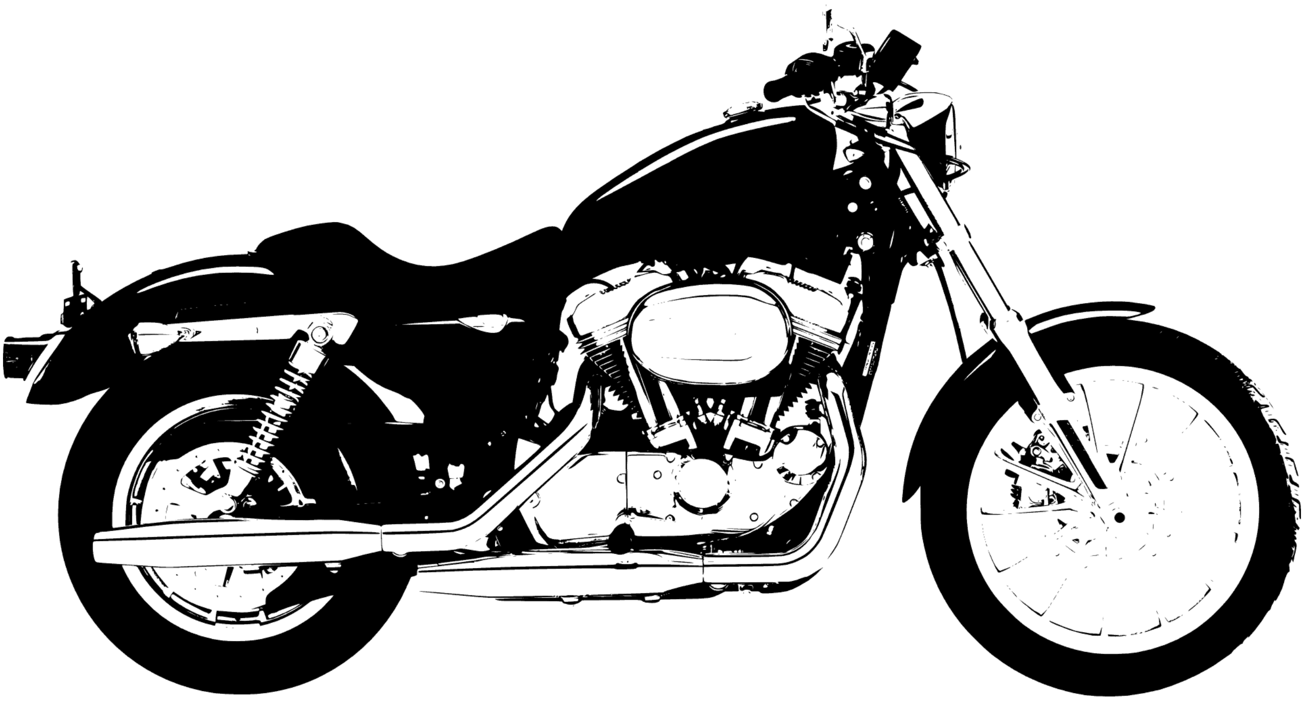
That clearly hasn't happened because of the lack of certainty of economic future. But all the money flooding around in the financial system has led to lower deposit rates making lives of senior citizens difficult, who have no other option but to cut down on their consumption. Even those who use fixed deposits to save for the future are caught in a jam.

To conclude, in this environment if inflation continues to remain stubbornly high, as it has through much of this year, the job of the government and the RBI to get consumption going will become even more difficult. It will also lead to the RBI finding it difficult to continue cutting the repo rate.

This column originally appeared in the Deccan Herald dated November 22, 2020.

19 November, 2020

# The Real Story Behind India's Two Wheeler Sales or Rather the Lack of It



Two wheeler sales are a widely used economic indicator. They give us a good indication of the prevailing spending capacity of the middle class. To put it in simpler words, is the middle class in the mood to borrow and spend money or simply spend money (given that everyone doesn't take a loan to buy a two-wheeler).

In the last few months, several economists, analysts, journalists, politicians and many Twitter warriors, have cited robust domestic two wheeler sales data *to tell us lesser mortals* that the economy is well on its way to revival.

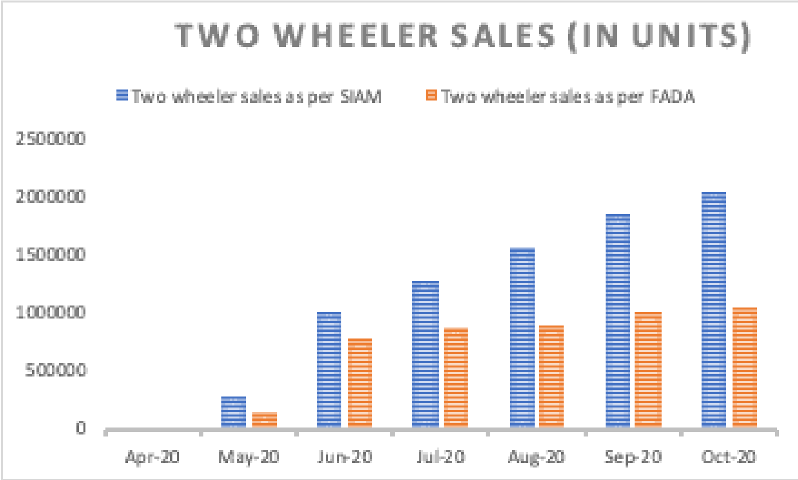
*But is that really the case?*

Two wheeler sales data are reported in two ways. The industry body Society of Indian Automobile Manufacturers (SIAM) publishes sales data every month. The Federation of Automobile Dealers Associations (FADA) also publishes this data every month.

The manufacturers produce the two wheelers and the dealers sell them to the end consumers.

Let's take a look at the following graph which basically plots domestic sales of two wheelers as reported by SIAM and FADA, for this financial year.

**What's that GAP?**




Source: SIAM and FADA.

As can be seen from the chart, there is a wide difference in sales as reported by SIAM and as reported by FADA (The blue bar is bigger than the orange bar throughout). Why is this the case? Let's look at this pointwise.

**1)** The only month where SIAM and FADA reported same sales was in April, when the economy was under a lockdown, and the two wheeler sales reported by both the bodies was zero.

**2)** While both the bodies report sales, what they report are totally different numbers. SIAM reports the number of units of two-wheelers leaving the gates of manufacturers or factory gate shipments. In simpler words, these are units which have been sold by manufacturers to dealers across the country, who in turn will sell to the end consumers.

In turn, FADA reports the number of units of two wheelers registered at the Regional Transport Offices (RTOs) across the country after they have been sold to the end consumer. Hence, the sales number reported by FADA is a better representation of sales to end consumers.

**3)** As can be seen from the chart, in every month from May to October, two wheeler sales as reported by SIAM were more than that reported by FADA. As per SIAM a total of 8.04 million units of two-wheelers were sold during the period April to October 2020, or the first seven months of this financial year. This is around 29.8% lower than sales reported by SIAM during the same period last year. Clearly, year on year sales are down even as per SIAM data.

**4)** As per FADA, the two wheeler sales during the period April to October stood at 4.78 million units, which is 3.26 million units or 40.5% lower than the number reported by SIAM. Cleary, there is a huge difference between the two numbers. One reason for this lies in the fact that the FADA data still does not capture registrations made at RTOs all offices across the country. The states of Andhra Pradesh, Madhya Pradesh and Telangana, are not hooked on to the Vahan 4 system from which FADA draws its data.

This explains a part of the discrepancy but it's still not good enough to explain the difference of 3.26 million units in the data between SIAM and FADA. The difference was more than a million units in October.

**5)** Why is the difference so huge? What SIAM is counting as sales is essentially inventory getting built up at their dealer level, something that the FADA data does not capture. This explains a bulk of the difference. A good proportion of the two wheeler units which have been sent from manufacturers to the dealers have not been sold to the end consumer.

Companies have been building up inventory with dealers across the country in the hope of good festival season sales. Also, the new Bharat Stage VI emission norms came into force from April 1. This meant that the inventory of two-wheelers at the dealer level had to be built all over again.

In fact, in its October press release, FADA pointed out that the inventory at the dealer level was at its highest in this financial year and it may impact the financial health of the dealers. In September, FADA had pointed out : "Inventory for two wheelers stands at 45-50 days". It has only gone up since then.

**6)** Has this strategy of companies piling up inventory at dealer level in the hope of festive season sales worked? The answer to this question will become *clearer* once we get the November data from both SIAM and FADA, early next month.

Hero Motorcorp has put out a press release saying it has had a good festival season.  As the company points out:

> *"Despite the severe disruptions on account of the Covid-19 this year, the good retail off-take during the 32-day festival period – spread between the first day of Navratra and the concluding day after Bhai Duj – was 98% of the festive season volumes sold by the Company in the previous year (2019) and 103% compared to the same period in 2018."*

The question is does this apply to the sector as a whole or has Hero Motorcorp simply been gaining market share? The festival season this year was from around the middle of October to the middle of November. The October data as we have already seen hasn't really been inspiring on the end consumer sales front with a gap of more than a million units in the sales data as reported by SIAM and FADA.

To conclude, two wheeler sales this year have been weak. As we have already seen, they are down 29.8% year on year, as per SIAM. As per FADA, they are down close to 40.3% year on year. This is the real picture of two-wheeler sales in the country and not the one several economists, analysts, journalists, politicians and many Twitter warriors, have been citing to us lesser mortals.

Of course, things may have improved a tad in November due to the Diwali festival. But will that be good enough to pull the industry out of the mess that it currently is in? I have my doubts about that. Also, in the months to come, the pent up demand will get exhausted. Further, one reason people are buying two wheelers these days is to avoid travelling by public transport. This is likely to have played out by the end of the year.

It will be interesting to see what happens next. Meanwhile, it is safe to say that a large part of the *great Indian* *middle class* isn't really in the mood to spend currently like they did in the past.

18 November, 2020

# Is My Bank Deposit Safe? That's Not the Right Question to Ask.

The Lakshmi Vilas Bank has been put under a moratorium for a period of thirty days. The deposit withdrawals during this period have been limited to Rs 25,000. Let's take a look at this pointwise.

**1)** The Lakshmi Vilas Bank is going to be merged with DBS Bank of India, the local unit of Singapore's largest bank, the DBS Bank. The Section 45 of the Banking Regulation Act 1949 empowers the RBI to 'make a scheme of amalgamation of a bank with another bank if it's in the depositors' interest or in the interest of overall banking system.'

Hence, if a bank is in bad shape and there is a risk of the depositors losing their money, the RBI has the power to merge this bank with another bank, in the interest of the overall banking system. This is precisely what is happening in this case.

**2)** The Lakshmi Vilas Bank has been in bad shape for a while. In fact, its gross non-performing assets or bad loans as of September 30, 2020, stood at 24.45%, which means that nearly a fourth of the loans given by the bank haven't been repaid. Bad loans are largely loans which haven't been repaid for a period of 90 days or more. Hence, the amalgamation of the bank with a bigger bank makes sense. Also, no public money is being spent for this rescue and that's always a great thing.

**3)** This is not the first time that the RBI is merging a bank which is in a mess with a stronger bank. In the early 2000s, the Global Trust Bank was merged with the Oriental Bank of Commerce. In the early 1990s, the New

Bank of India was merged with the Punjab National Bank.

**4)** The money of the depositors in the Lakshmi Vilas Bank is safe. It's just that they can only withdraw up to Rs 25,000 over the next thirty days. This is where the problem starts. I am sure there must be many depositors out there who have all their savings in this bank. They will be in a spot of bother if there is an emergency and they need money. The trouble is they cannot withdraw more than Rs 25,000 and money which cannot be accessed when it is needed, is basically useless.

**5)** Many depositors in India follow the fill it, shut it and forget it, model of saving. Once they have money in a bank they automatically assume that it is safe and given that, they don't take the most basic precautions. This explains why so many people had all their savings in just one bank like the Punjab and Maharashtra Cooperative (PMC) Bank, which continues to be under a moratorium. In fact, there have been regular news stories in the Mumbai media about the depositors of PMC Bank needing money and being unable to access it. There will be similar individuals when it comes to Lakshmi Vilas Bank as well. This explains why the entire issue is much more than just the safety of deposits.

**6)** In case of Lakshmi Vilas Bank, it was very clear that the bank has been in trouble, unlike Yes Bank, which wasn't declaring the correct numbers. In March 2018, the bad loans of Lakshmi Vilas Bank were at 9.98%. They have been rising ever since. The bad loans crossed the 20% level as of September 2019, when they stood at 21.25%. Depositors should have been lining up for their money when the bad loans rate crossed 10%. If they didn't withdraw their deposits when the rate crossed 10%, they should have at least been lining up when it crossed 20%.

**7)** As of March 2018, the bank had deposits worth Rs 33,309 crore. By September 2019, deposits had fallen to Rs 27,864 crore, a drop of 16.3% over a period of 18 months. Given the fact, that the bad loans rate was heading towards 20%, not many people withdrew their deposits. Only the smart money moved out.

Between September 2019 and September 2020, the total amount of deposits with the bank shrunk by 24.7% to Rs 20,973 crore. Hence, quite a lot of money moved out of deposits in the last one year. Nevertheless, a bulk of the depositors stayed with the bank.

**8)** Why would one continue banking with a bank which has a bad loans rate of over 20%? There can be multiple reasons for it. The depositor is unaware of the state of the bank (fill it, shut it, forget it, as I said earlier). The depositor is aware of the state of the bank but feels that no bank will be allowed to fail. This is a fair assumption to a large extent, but there are conditions to this, while the deposits may be safe, there access might be a problem. Finally, the depositor just likes the fact that the bank is paying a higher rate of interest than other banks. Currently, the Lakshmi Vilas Bank is paying 7% interest on a 366 day deposit, in a market where most banks are paying 5-5.5% on a deposit of a similar tenure.

**9)** What are the lessons in this for all of us? The first lesson is the old investment cliché of *don't have all your eggs in one basket.* Hence, don't have all your savings in one bank. Spread them out. This ensures that even if one bank account is put under a moratorium, you have access to other bank accounts from which you can withdraw money. This is very simple advise but a lot of people don't seem to be following even this.

**10)** Keep a track of the bad loans rate of your bank. It is not very difficult. You can Google it up or there are many websites which share this data. As a rule of thumb, do not bank with a bank where the bad loans rate has crossed 10%. While the RBI will not allow a commercial bank to fail, you may have problems in accessing your money for a while, if the bank is put under a moratorium. And that can't possibly be a good thing.

**11)** What happens if the bank is not reporting its bad loans data properly? Yes Bank did this. Only after an administrator was appointed the real state of the bank came out. In this case it is very important to keep looking at the outstanding deposits of the bank. If they are shrinking by any chance, clearly there is something going on which you don't know about, but the insiders clearly do. Hence, it's time to withdraw your money.

**12)** Finally, every time a bank is put under a moratorium or even otherwise, the question that most people seem to ask is, are my bank deposits safe. As an outsider, there is no way for anyone to determine that 100%. Hence, the question to ask is, *how do I make my bank deposits safer if not totally safe.* And the way to do that is to follow the methods mentioned just above.

Between March 27 and October 23, the total amount of deposits with commercial banks in India, have risen by Rs 6.32 lakh crore or 4.4%. This has happened despite falling interest rates and high inflation. This means that the average Indian depositor is more interested in return of capital rather than return on capital. He doesn't want to take on much risk while he is investing.

But not taking much risk doesn't mean that one switches off totally after depositing money with a bank and has zero idea of the state of the bank. We are in the twenty first century and we need to be able to do a little better than that. It's your *Lakshmi* at the end of the day and you need to take care of it.

3 November, 2020

# Why Large Parts of North India Turn Dystopian Every Winter

*— Picture by Neil Palmer (CIAT). Burning of rice residues in Punjab, India, prior to the wheat season.*

## *In the end, it's all about incentives, perverse or otherwise.*

My parents moved to Delhi in 2009, after my father retired from Coal India. Since then I have spent all Diwalis in Delhi, though this Diwali due to reasons beyond my control, I will most probably be in Mumbai.

The last few Diwalis in Delhi have been very difficult for me. In fact, last year, I could smell smoke inside the house even before the Diwali day (so, it was clearly not because of crackers). Delhi and many other parts of North India go *totally dystopian* during winters.

On some days when one gets up and looks out of the window, there is so much smog that one gets a feeling that Armageddon is here.

One of the primary reasons for this smog/pollution is the rice stubble burning that happens in Punjab, Haryana, parts of Uttarakhand and Western Uttar Pradesh. From the looks of it, the situation doesn't seem to be very different this year.

Newsreports suggest that stubble burning is currently on and was responsible for 40% of Delhi's pollution on November 1, the highest it has been so far this season. Last year on the same day, the stubble burning's contribution to Delhi's pollution had stood at 44% on November 1.

Let's try and understand this issue in detail and why it happens every year.

This is a great story of how *noble intentions* on part of politicians and bureaucrats (yes, you read that right) along with incentives that seem right when they are introduced, can really *screw up* things in the years to come.

And once a system is in place, right or wrong, it is difficult to change it, given that many individuals benefit from the status quo.

**Why do farmers burn rice paddy stubble?**

They do it primarily because the time farmers have between harvesting rice paddy and sowing the wheat crop, is very short. That's the short answer. But there is a lot more to it than just this.

Mechanical harvesters found their way into Punjab sometime in the early 1980s. Around four-fifths of the rice crop is harvested using combine harvesters and not human beings (if you still thought humans being carry out harvesting in Punjab, you haven't moved beyond Hindi cinema of the 1960s).

These harvesters cut and clean rice from the rice paddy, but they leave behind straws on the field. These straws are six to eight inches long and for all practical purposes are useless.

The straws remaining after harvesting of wheat can be used as animal fodder. Rice straw cannot be used as animal fodder primarily because of its high silica content. If this straw is used as animal fodder, it impacts the quality of milk, with the quantity of calcium in the milk coming down. This is not true about straw left behind after harvesting basmati rice, which has low silica content.

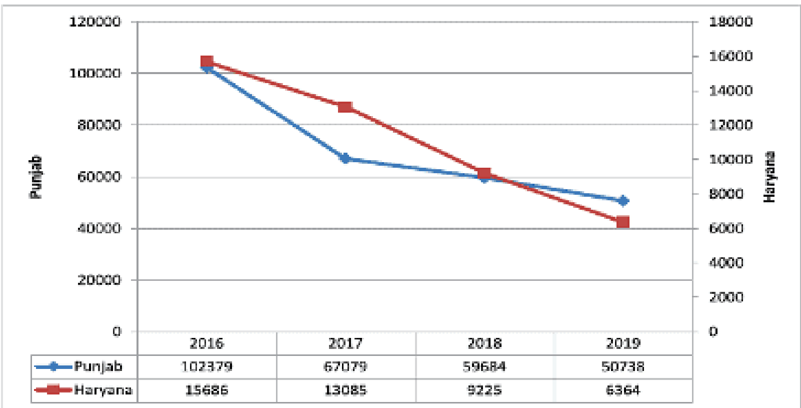
But basmati is grown only in a limited area . Like this year, rice was planted on a total area of 27.36 lakh hectares. Of this, basmati was planted on around 6.5 lakh hectares or 24% of the total area under rice. This was primarily because the government does not buy basmati rice under the minimum support price (MSP) structure. (We shall look at this in detail later).

Farmers have a time of around 10-15 days for removing the rice straw and get the fields ready for planting wheat. The easiest thing in this situation is to burn the rice straw. All it takes is a single well-lit matchstick. The cost is close to zero.

This burning leads to higher pollution and deterioration of air quality even in places hundreds of kilometres away. The heat from burning the rice straw leads to an increase in soil temperature which kills beneficial soil organisms. The burning is also a potential source for greenhouse gases. Also, it is worth remembering that the burning of post-harvest rice stubble forms around 50% of the all the crop residue burning in the country.

Let's take a look at stubble burning in incidences reported in Punjab and Haryana, where most of the burning takes place.

**Chart 1.5: Number of Incidences of Stubble Burning Reported in Punjab and Haryana during 2016 to 2019 (1st October to 30th November)**




Source: *Price Policy for Kharif Crops – The Marketing Season of 2020-2021* , Commission for Agriculture Costs and Prices.

As can be seen from above table, the number of stubble burning incidents have come down over the years. The total number of incidents in Punjab and Haryana have come down by 52% between 2016 and 2019. In 2016, the total number of incidents had stood at 1,18,065. By 2019, this was down to 56,742.

So there has been some improvement on the number of fires front over the years. But there are other ways of looking at the situation; the total weight of the stubble burned and the total area of stubble burned. The Chief Secretary of Punjab Vini Mahajan said on October 31 , that the total straw burning area in 2020 was 7.49 lakh hectares, which was 5.23% lower in comparison to 7.90 lakh hectares last year.

A Amarender Reddy, the principal scientist at the ICAR-Central Research Institute for Dryland Agriculture recently wrote in The Wire that last year the farmers burnt 11 million tonnes of rice stubble in Punjab and Haryana. This is a little over 40% of the total stubble of 27 million tonnes of rice stubble produced in both the states. Reddy expects the figure to be the same this year.

There has been some improvement on the paddy burning front. One reason has been the distribution of Happy Seeder, a machine which cuts rice stubble and plants wheat seeds at the same time. Reddy writes that the Punjab government has distributed around 24,000 Happy Seeder machines though the state needs nearly 50,000 seeder machines to remove all the rice stubble in the short period of time available before wheat seeds are planted.

Also, farmers have complained about low germination of wheat seeds when the Happy Seeder machine is used. The central government, like most central governments, has allocated more money to solve the problem. Using this money, machines to tackle the rice stubble can be bought at a subsidy.

While, all this is fine, it doesn't answer the most basic question: why do semi-arid states like Punjab and Haryana, grow a water-intensive crop like rice paddy in the first place?

**Why Punjab and Haryana grow rice?**

Punjab has the highest yield of 4,132 kgs per hectare when it comes to rice, against the all India yield of 2,659 kgs per hectare. The rice productivity in Haryana is better than the all India average and is at 3,121 kgs per hectare. But this does not take into account the total amount of water used to produce this rice.

As the document titled *The Price Policy for Kharif Crops: The Marketing Season for 2016-17* , brought out by the Commission for Agriculture Costs and Prices, points out:

> *"If water consumption is measured in terms of per kilogram of rice, West Bengal becomes the most efficient state, which consumes 2,169 litres to produce one kg of rice, followed by Assam (2,432 litres) and Karnataka (2,635 litres). The water use is high in Punjab (4,118 litres), Tamil Nadu (4,557 litres) and Uttar Pradesh (4,384 litres). … [This] shows that the most efficient state in terms of land productivity is not necessarily the most efficient if irrigation water is factored into. This is because of high rainfall in the eastern region."*

Haryana also uses a lot of water to grow rice.

What this means is that Punjab and Haryana given that they are semi-arid water deficient areas, should not be growing rice in the first place. In the early sixties, Punjab used to grow crops which did not require a lot of water. These included maize, bajra, pulses, oilseeds etc. But over the years, the share of these crops in the overall cropped area has come down dramatically. Take a look at the following table.

*Table 16: Crop wise percentage share of cropped area*

| Crops | 1960-61 | 1970-71 | 1980-81 | 1990-91 | 2000-01 | 2018-19 |
|---|---|---|---|---|---|---|
| Paddy | 4.8% | 6.9% | 17.5% | 26.9% | 31.3% | 39.6% |
| Maize | 6.9% | 9.8% | 5.6% | 2.5% | 2.1% | 1.4% |
| Bajra | 2.69% | 3.7% | 1% | 0.2% | 0.1% | 0% |
| Wheat | 27.3% | 40.5% | 41.6% | 43.6% | 43.1% | 44.9% |
| Barley | 1.4% | 1% | 0.9% | 0.5% | 0.3% | 0.1% |
| Pulses | 19.1% | 7.3% | 5% | 1.9% | 0.7% | 0.4% |
| Oilseeds | 3.9% | 5.2% | 3.7% | 1.5% | 1.1% | 0.5% |
| Sugarcane | 2.8% | 2.3% | 1% | 1.3% | 1.8% | 1.2% |
| Cotton | 9.4% | 7% | 9.6% | 9.3% | 7.6% | 5.1% |
| Vegetables | 1.2% | 0.9% | 1.1% | 0.7% | 1.3% | 3.3% |
| Fruits | 0.6% | 0.6% | 0.4% | 0.8% | 0.5% | 1.1% |
| Other crops | 17.7% | 14.8% | 12.6% | 10.8% | 10.1% | 2.4% |

*Source: Directorate of Agriculture and Farmers' Welfare, Punjab*

Source: Economic Survey of Punjab, 2019-20.

Rice paddy was grown only on 4.8% of cropped area in 1960-61. In 2018-19 it was grown on around 39.6% of cropped area. What happened here? Sometime in the mid 1960s, the central government launched the *Green*

*Revolution* in Punjab, in order to build food security in India and reduce our dependence on import of American wheat under the Public Law 480 (PL -480).

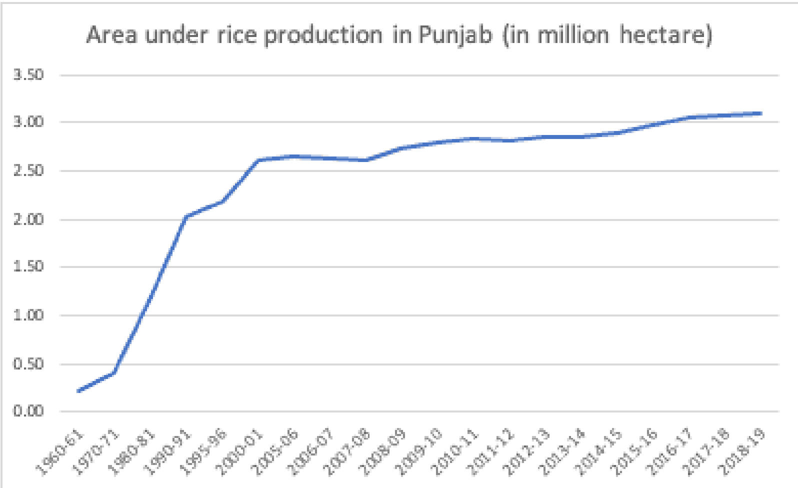
The farmers were encouraged to plant a high-yielding variety of wheat. In order to incentivise them, the government bought this wheat from them at a minimum support price (MSP) which was declared every year.

A look at the above table tells us that the cropped area under wheat jumped from 27.3% in 1960-61 to 40.5% in 1970-71. The fact that the government bought the wheat at the MSP, led to an increase in wheat plantation.

The government started buying rice at an MSP as well. This led to a jump in number of farmers planting rice in Punjab and Haryana because they had a readymade customer in the government willing to buy at a fixed price. They weren't subject to the vagaries of price and India's underdeveloped agricultural marketing system.

The farmers were first incentivised to grow wheat (rightly) and then incentivised to grow rice as well (right from the point of food security, but wrong from all other angles).

Take a look at the following chart which plots the total amount of area on which rice has been planted in Punjab, over the years.

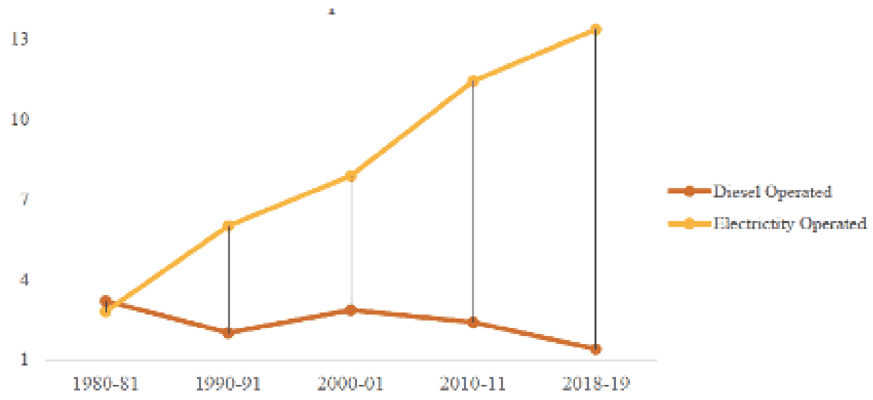



Source: http://punenvis.nic.in/index3.aspx?sslid=5882&subsublinkid=4993&langid=1&mid=1 and Agricultural Statistics at a Glance 2019.

As can be seen there was a major jump in the area under rice production between 1970-71 and 1990-91, from 0.39 million hectare to 2.02 million hectare. This was primarily because of rice being bought by the government at a minimum support price announced every year. The next jump came in the mid 1990s.

In the year 1997, free electricity for farmers was introduced in Punjab. This encouraged farmers to grow rice even more. They could now pump groundwater for free. This could be used to grow rice. Take a look at the following table, which plots the number of tube wells in the state over the years.

**Number of tubewells (in lakhs)**




Source: Economic Survey of Punjab, 2019-20.

As can be seen from the above table, the number of electrically operated tube wells has gone up dramatically over the years. In 2018-19, the number is more than 13 lakhs. With free electricity, farmers were incentivised to buy electricity operated tube wells and pump as much ground water as required to grow rice.

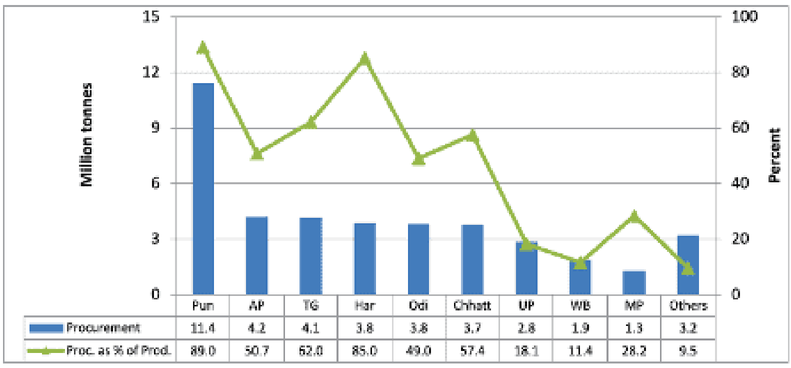
This has led to the exploitation of groundwater. As the latest Economic Survey of Punjab points out:

> *"A state-wise assessment of the groundwater resources in the country showed that 80% of 138 blocks assessed were 'Over-exploited', 2 blocks were 'Critical', 5 were 'Semi-Critical', and 22 were 'Safe'."*

In fact, 95% of groundwater is extracted for the purpose of irrigation.

Along with this, the Food Corporation of India (FCI) buys up a bulk of the rice produced in the state. It is worth remembering here that Punjab is not much of a rice eating state. Take a look at the following chart.

**Procurement of rice in major producing states.**




Source: Price Policy for Kharif Crops – The Marketing Season of 2020-21.

In 2018-19, Punjab produced around 12.82 million tonnes of rice. Of this, 11.4 million tonnes was procured by the government through FCI and other state procurement agencies. In Haryana, around 4.5 million tonnes of rice was grown. Of this, around 85% was procured. The major reason for this lies in the fact that given the green revolution started here, FCI has the best infrastructure to procure and store foodgrains, in this area.

The government doesn't procure basmati under MSP because there is a huge international demand, given its fragrant smell when cooked. Hence, farmers don't plant much of it. While there is international demand, the farmers also need to suffer the vagaries of price.

This easy procurement along with free electricity encourages farmers to grow rice in what is largely a semi-arid area. But this still does not explain how the farmers came around to burning rice paddy stubble. I mean, I have been going to Delhi for more than 35 years now, but the city was never *dystopian* during winters earlier. This is clearly a phenomenon of the last decade. What changed?

**What led to farmers burning rice stubble?**

As we have seen, the government policies over the years, have incentivised farmers to grow rice. At the same time, these policies have led to the water table in Punjab falling dramatically. Given this, the government had to something about this and it did. (I am talking more about Punjab than Haryana here, simply because the number of fires in Punjab is many times more).

As the Economic Survey of Punjab points out:

> *"It requires 4,500 litres of water to grow one kg of sathi rice when it is sown in April-May. But if sowing is done around mid-June, water requirement reduces to 1,500-2,000 litres. Water requirement is high in April-May because the evaporation rate is high and there is no rain. As a result, all the water used in irrigation is groundwater. In June-July, rainfall supports water needs of the crop."*

This logic essentially led to the enactment of the Punjab Preservation of Subsoil Water Act in 2009. As per this law, farmers are not allowed to sow paddy seeds in nurseries before May 10. They are not allowed to transplant the saplings before June 10. The idea being that by the time farmers start transplanting the saplings in the fields, the Monsoon would have already arrived and hence, lesser groundwater will be used to grow rice. Haryana has a similar law.

The intention behind the law was noble, but the incentive it created for the farmer was again perverse. The end to end production of rice takes 120 days. The process of growing rice used to start in April earlier. But this was pushed back by a month due to the law to prevent the overexploitation of groundwater.

This led to a situation where farmers were left with a time of around 15 days to get their fields ready for the plantation of wheat. The quickest way to turnaround is to burn the rice stubble and that is precisely what has been happening for the last decade.

History plus perverse incentives are at the heart of this problem.

**What's the way out of this?**

The central government recently told the Supreme Court that it was planning to bring a new law to tackle the stubble burning problem . This is a classic way of how any government tries to tackle a long-term problem. They either bring a new law or throw money at it, in the hope of solving the problem.

But the question is will this law or any law be of help? The Punjab government did bring in a law to solve one problem and ended up creating another one, without really solving the first one.

In the short-term, innovations like the Happy Seeder have clearly helped. But the problem can only be solved if the Punjabi and other farmers in the semi-arid areas of North India are incentivised to not grow rice and to grow other crops which do not require a lot of water.

But at the risk of repeating a cliché, *it is easier said than done* .

Let's take a look at this pointwise.

**1)** Over the years, the government has bought much more rice and wheat than it needs to maintain the operational reserve and the strategic reserve. Like in September, the rice stock in the central pool of the FCI was at 22.2 million tonnes. As of October every year, FCI needs to maintain an operational reserve of 8.25 million tonnes and a strategic reserve of 2 million tonnes. Clearly, the FCI has much more rice than is required.

This reserve can be brought down by buying lesser rice in the time to come. If this policy is followed for a few years, the farmers will automatically be disincentivised to grow rice. If they are disincentivised to grow rice, there will be lesser rice stubble to burn.

Of course, this is a politically risky move and in the process a section of farmers is bound to face losses, until they move away from growing rice.

**2)** Another way is to buy more rice from states like West Bengal, which is best suited to be growing rice, given it uses less water to grow rice, in comparison to other states. In fact, West Bengal produced 16.05 million tonnes of rice in 2018-19. Of this, the government purchased just 1.9 million tonnes. The point to remember here is that West Bengal is a rice eating state.

So, unlike Punjab the government cannot buy almost all the rice that is produced. Hence, buying by the central government shouldn't lead to a shortage of rice in the state, forcing it to buy rice from other states, in the process. The solution lies in helping increase the rice yield per hectare in the state. In 2018-19, West Bengal produced 2,906 kgs of rice per hectare. This was significantly lower than Punjab's 4,132 kgs per hectare, but more than the national average of 2,659 kgs per hectare.

**3)** The most important way in weaning away farmers from rice is to change incentives. Let me offer an analogy here. Why does a wealth manager/insurance agent/personal banker/mutual fund agent mis-sell? Simply because their incentives are so aligned.

Along similar lines, if the farmer has an incentive to grow rice (and unlike financial salesmen, the incentive here is an honest one), he will grow rice. We can't judge him for this.

One way out is to encourage farmers to grow maize, like they used to in the sixties. In 1960-61, 6.9% of the total cropped area in Punjab was used to grow maize. By 2018-19, this had fallen to 1.4%. As the document titled *Price Policy for Kharif Crops—The Marketing Season of 2020-21* points out: "Maize cultivation is more water efficient than rice… [It has] a great potential for crop diversification in rice-wheat cropping system areas of north-western plains, where substantial groundwater depletion has occurred."

The trouble is that maize has low profitability in comparison to rice "due to low and fluctuating prices and yield of maize."

As the Price Policy document points out:

> *"There is a need to find alternative uses of maize in the country for industrial uses like feed, starch and ethanol as well as for direct consumption, mainly value-added products… Allowing maize as raw material for ethanol production would help in crop diversification and ensure remunerative prices to farmers."*

This will help increase the demand for maize and help increase its price.

Along similar lines, there is a need to encourage and incentivise the growing of pulses and oilseeds, which we don't grow enough of. As the Price Policy document points out:

> *"Instead of promoting water-intensive crops like rice… it is important to promote production of pulses and oilseeds by encouraging farmers to grow these crops by providing better quality seeds, technology and appropriate price support to address gap between domestic production and consumption and maintain stability in the domestic market."*

The fact of the matter is that the private agriculture markets in the country don't function well. At the same time, in order to encourage farmers to grow particular crops, the government cannot buy a large amount of it, like it buys rice and wheat, simply because it doesn't have enough money to do so or the right infrastructure to store what it has bought. Pulses are an excellent example. The reason FCI cannot buy pulses is simply because it doesn't have the right infrastructure to store them.

In this scenario, getting farmers to grow something other than rice is going to be very difficult and will take a lot of concentrated effort on part of the politicians as well as bureaucrats. Will that happen? On that your guess is as good as mine.

The moral of the story being, just because there is a problem, doesn’t mean it has an immediately implementable solution.

29 October, 2020

# Should You Buy a Home This Festival Season?

In the last decade, afternoon naps have become a very important part of my life. In fact, it is safe to say that I live so that I can have the pleasure of taking afternoon naps and reading crime fiction. ( *Imagine all the economics I have to break my head on, for such simple pleasures in life* ).

After taking an afternoon nap yesterday I was trying to get my *brain going again* by drinking a cup of overboiled masala tea. At around 4.54 pm, a mail titled *10 Reasons to Buy a Home This Festive Season,* hit my mailbox. The headline ensured that my brain was back to functioning at full strength.

In the economic environment that currently prevails, only someone closely associated with the real estate business could come up with a headline/title like this. Not surprisingly, this piece was written by someone working at a senior position for a real estate consultant, whose well-being depends on the sector doing well. His incentive is clearly misaligned with that of a prospective buyer looking to buy a home to live in.

Also, the festival season sales pick up is something that the real estate sector has been trying to sell for more than half a decade now. This tells you that *bad ideas rarely go out of circulation* .

This headline motivated me to write this piece titled *should you buy a home this festival season* , which you are currently reading.

Let’s take a look at this pointwise.

**1)** One of the reasons offered to buy a home in the mail I got, is the oldest cliché in the game, which goes like this: " *Living in a rented house is a recurring financial drain without returns on investment* ". This reasoning is bought by one too many people even though it is *the rubbish of the highest order* .

Let me explain through an example. I stay in central Mumbai, in what is euphemistically termed as a studio apartment. My monthly rental outgo is Rs 23,000. What sort of a home loan will I get if I am willing to pay the same amount as an EMI? At an interest rate of 7% per year on a home loan to be repaid over twenty years, I will get a home loan of around Rs 29.67 lakh. On this loan, the EMI works out to Rs 23,003.

Let's say to this home loan I add my own savings of around Rs 10.33 lakh and I have a total of Rs 40 lakh, with which I can buy a flat. I will not get anything at this price around where I live unless I am willing to move into a shanty.

To get an apartment at this price I will have to move 35-40 km or even more from where I stay. And that will beat the entire idea because I like staying where I do and renting is the only way I can afford it. I am not looking to build an asset here. I just want to stay bang in the middle of the town.

**2)** Also, the rental yield typically tends to be 1.5-2% (annual rent divided by the market price of the house) or slightly higher. Even the cheapest home loan is 7%. Plus there are other costs associated with owning a home. When you a buy a house a stamp duty has to be paid to the state government. A property tax needs to be paid every year. Then there is the maintenance charge that needs to be paid to the housing society. On top of this there is the general risk of owning property in India.

**3)** Further, if I go and live 35-40km from where I am, I will end up paying for it in terms of the time I will have to spend to get anywhere. And time ultimately is money. So, yes one might end up building an asset but with almost no control over one's time.

Hence, equating living in a rented house to a financial drain is *top class rubbish* which only someone working in the real estate industry can come up with and propagate over and over again. This argument starts to make sense only when the rental yields and home loan interest rates are in a similar sort of territory. For that to happen, rental yields need to double and home loan interest rates need to halve ( *both will then be around 4%* ).

**4)** Another reason offered in the mail, to buy a house is: "Buying now equals buying at the lowest possible price." Lowest possible price, vis a vis what? Entry level flats in the biggest cities, where the bulk of the demand is, cost at least Rs 40-50 lakh. Let's consider a flat which costs Rs 40 lakh. A 20% downpayment works out to Rs 8 lakh. This means a home loan of Rs 32 lakh. The EMI on this works out to Rs 24,809 (7% interest, 20 years repayment period).

A bank typically assumes that around 35-40% of the after tax take home salary can go towards paying this EMI. If the assumption is that around 35% of the salary goes towards EMI, the total after-tax take home salary works out to around Rs 8.5 lakh. The pre-tax salary has to be even higher, more than Rs 10 lakh. How many people make that kind of money in a country where the per capita income is just over Rs 1.5 lakh, is a question well worth asking. This very conservative example explains why real estate in India remains beyond the level of most Indians.

**5)** There is another problem with the *lowest possible price* argument. Given the opaqueness surrounding the real estate sector in India, there is nothing like a market price at any given point of time. So how do you even know that the price offered to you is the lowest possible price? Do you just believe what the builder or his broker are saying? Do you have any idea what the price was last year or the year before that?

**6)** Also, we are told that "home loan interest rates are at 15-year low". Hence, you should buy a house. The economy during the period April to June contracted by a nearly fourth. It is expected to contract by 10% this year, a level of contraction never seen since Indian independence. Just because home loan interest rates are low should you go out and buy a house? The more important question to answer as always is whether you are in a position to pay the EMI payable against the low interest rates. No wonder this very important point has been missed out on.

It is worth remembering that home loans are floating interest rate loans and interest rates can keep changing in the years to come. If you take on a 20-year home loan now, it doesn't mean that interest rates will continue to remain low for the next 20 years.

**7)** And then there is this, my absolute favourite, which I have been hearing for years now: "The property market is poised on the cusp of a full-fledged revival. Once the revival kicks in, property prices will harden and asset appreciation begins in all seriousness."

This statement reminds me of the different chairpersons that the State Bank of India has had in the last twelve years. Starting with 2009, each one of them has said at some point of time that when it comes to the banking sector in India, the worst is behind us. Well, it's 2020, the banking sector still has *official* bad loans of close to Rs 9 lakh crore and they are expected to go up dramatically post-covid.

Every festival season for the last six years the real estate sector has been talking about an impending revival. This revival did not happen when the Indian economy was growing. And now they expect the revival to happen in a year when the economy is contracting big time. The size that the Indian economy achieved in 2019-20, will now *most likely* be achieved again only in 2022-23. Jobs have been lost. Incomes have fallen. Small businesses have shut-down or are on the verge of shutting down and the real estate sector is talking about *asset appreciation beginning in all seriousness* .

I mean all selling involves *some amount of fibbing* but if you keep doing it all the time and it doesn't turn out to be true, it loses its power. People start believing in the opposite narrative. As the old fable of the jackal shouting *sher aaya sher aaya* goes.

**8)** Here's another reason the mail offered, to buy a house: "After a protracted period of financial upheaval, it has become necessary to revisit all expenses which represent undue pressure on personal finances. *Living in a rented house is a recurring financial drain without returns on investmen* t [emphasis added]."

The part italicised in the above paragraph I have already dealt with in the first point. Nevertheless, the above paragraph needs to be tackled on its own as well. What is the writer saying here? Given the tough economic conditions created by covid, it is time to revisit all expenses. Yes, that makes sense.

But then he goes on to say that renting doesn't make any sense and you need to make an even bigger expenditure in buying a house and paying an EMI. Buying a house would involve running down savings to make a downpayment and paying a stamp duty. Then there would be moving charges.

At the same time an EMI would have to be paid on a home loan. The chances are that the EMI will be much more than the rental.

Why would anyone who is in financial trouble and trying to cut down on his expenses, be expected to take on higher expenses by buying a house? What's the logic here? There is no logic to this except to *confuse* the prospective buyer.

Essentially you are being asked to be *penny wise and pound foolish* .

**9)** In the last couple of weeks, the real estate industry has been trying very hard to convince us that the buyers are back in the market and they are lining up to buy homes. Like the mail I got put it: "The best home options are being snapped up at a rapid pace."

Similar stories have been seen in the media as well. Like the Mumbai edition of The Times of India points out today: "Unlocked MMR shines with 60% rise in home sales in Q2". Only when you read the story carefully you realise that sales in the Mumbai Metropolitan Region (MMR) during July and September were 60% higher than sales during April to June. And that's hardly surprising. There were barely any sales in April and May, due to the lockdown. Hence, this was bound to happen.

The real question is how do things look in comparison to July to September 2019. This reveals the real story. Sales between July to September 2020 are 40% lower than the same period last year. Of course, the newspapers are trying to project a real estate revival story given that they are dependent on huge advertisements from real estate companies. Also, it is worth remembering that a lot of home sales that happened in July to September must be pent up demand from April to June, which has spilled over.

**10)** Another tactic being employed here is to project a lack of supply. As the mail I got puts it: "Developers have curtailed new supply". Maybe they have. But the larger point here is that lakhs of apartments were bought as an investment in the decade leading to 2015. Many investors are still sitting on it, hoping for a better return. But now due to covid, there are bound to be quite a few distress sales going around. So, it's a matter of hanging around and looking for one.

As I have said in the past, the real estate market right now is going through a weird low supply low demand situation. There is *low demand for real estate* (given the high price) and there is low supply as well (given that real estate companies and individual owners are unwilling to cut prices). I may want to buy a home but unless I have enough money and the ability to borrow to do so, I am really not adding to demand. Just wanting something, without having the money to finance it, doesn't really add to demand.

This situation can only turnaround if the demand improves or if the supply improves. The demand will improve *only* when the economy turns around and India grows at 7-8% for a sustainable period of time, leading to increased incomes. The supply will improve if prices fall (which means more people are willing to sell the homes they own), of course, that will lead to an increase in demand as well.

Dear reader, you must be wondering by now, *itna gyan de diya,* now tell us if we should buy a home or not. First and foremost, *what does buying a house have to with one year's festival season* or for that matter any other's? You are not buying a mobile phone, which you buy almost every couple of years and wait for the best deal during the festival season. A home is only bought once or twice during a lifetime.

You should buy a house if you want to live in it, can afford to make the downpayment and *most importantly* , have a *stable income* which will allow you to keep paying the EMI on the home loan in the years to come. This also includes the idea of buying a bigger home to adjust to the new reality of working from home.

As mentioned earlier, the most important part here is stable income. If your job or business is on shaky ground, now is not the time to buy a house. If you want to continue living in the posher area of the city, but can only afford to pay a rent for it, then now is not the time to buy a house.

Remember, while you might be building an asset by not paying a rent but by paying an EMI, you are probably also making a compromise in terms of the time you have at your disposal to live the life you want to. If you are comfortable with the idea of *a daily rat race* then please go ahead and buy a house.

On the flip side, there are advantages to owning a home. One is the fact that you don't have to change homes frequently, like you have to if you are living on rent. Over the years, I have come to the conclusion that this fear is oversold. The days when landlords used to be only landlords are gone (of course a lot of such people do survive).

Now there are many landlords who have full-fledged corporate careers and are more interested in a regular rental than changing people who they rent out their homes to, every 11 months. *Remember it's a pain for them as well.* Also there is the risk of not finding a tenant on time and losing out on a month's rent. And any sensible landlord will want to avoid that.

The biggest advantage to owning a home is that it tends to make your parents happy (in terms of getting settled in life). Also, the kids can have a slightly stabler life. But it all boils down to whether you can afford to buy a home. On this front, every individual's situation is different and you need to figure that answer out for yourself. If you feel comfortable with buying a house right now then please go ahead and do that. Don't wait.

As far as investing in real estate is concerned so that you can flip it later, that idea went out of style in 2013 or 2014 at best. If you still believe in it then either you deal in a lot of black money or probably don't realise that *the times have changed* .