UTI Economists Desk -- Mr. Charanya
REFORMS : The Pain in the Rain!

On Friday, the government opened the gate to a slew of big bang reforms - and it rained reforms. This day can also be seen as the most significant day of UPA's second term. These reforms as you are aware have been long awaited but they found their way out on Friday. Thursday saw diesel prices being hiked by nearly 12% while Friday saw a string of reforms such as approving 49% FDI in civil aviation, 74% FDI in broad cast services, FDI in power exchanges and 51% FDI in multi brand retail. We think the moves are hardly bold but looking back into the government's past, they are definitely significant. But why was Friday chosen? Was this a result of anxiety or acumen? Is there any pain in this rain?

In the past, the government has faced quite a bit of flak from the foreign media (Washington Post referred to the PM as a "tragic figure", Time Magazine carried a cover story calling the PM an "underachiever") besides being embroiled in one controversy after another (read: Coalgate, 2G spectrum etc). Given this milieu, reforms rain should have come in long ago - why then did they choose as late as Friday to be the moment to rain reforms? The reasons could be that with the Parliament being adjourned and with the two state assembly elections (Gujarat and Himachal Pradesh - Nov 2012) coming up - allies might think twice before rocking the government's boat. Muted responses to the diesel price hike perhaps gave the government a chance to try their luck harder and open up FDI. Therefore Friday was perhaps chosen out of anxiety.

Just to give you a peak into the what, what if and why nots of the reforms announced:

FDI in civil aviation - a much needed positive reform. It is certain that policy makers would most likely justify this move by citing the Kingfisher Airlines case. But if that was the concern in the first place, FDI should have been approved last year itself rather than waiting until Kingfisher sank in a Rs 70 bn debt with an equal amount of losses. That way Kingfisher would have gotten a lease of life - but this wasn't done. Why? Perhaps to ensure that close friends become beneficiaries (Spice Jet, GoAir and the others but not Kingfisher).

FDI in multi brand retail - Indeed a puzzling move. The goodness about allowing FDI into retail is that it would help get rid of middlemen in the supply chain network. But the problem with this move is the impact it has on most kirana stores and even political parties. Given the fact that states like UP opposed retail outlets owned by Reliance, the likes of Wal Mart are not going to have it easy. Also net gains would end up more with retailer than producers. We say this because the findings from a study on the linkages between farm gate and retail prices indicate that the share of the retail prices received by farmers have fallen consistently from 41% sharply down to 18.5% in 2006.

Another problem with the rain is its timing - At a time when big Indian retail firms like Pantaloons have been sinking in debt, perhaps this move will again help close friends of the government reduce their debt by selling off their stakes. On the other hand, banks have been worried about their big exposure to retailers and this move will help them save their loans from ending up as NPAs. Most banks being PSU banks - the measure will work out to be positive in reducing the fiscal deficit.

The govt cleared stake sales in four undertakings (MMTC @ 9.33%, Oil India Ltd @ 10%, NALCO @ 12.15%, Hindustan Copper Ltd @ 9.59%) which together must garner disinvestment proceeds for the government to the tune to Rs 150 bn (half of FY 13's BE of Rs 300 bn). The only way to get more cash to make the fiscal deficit look smaller would be the mug the PSUs and sell their shares. While using disinvestment as a mode to cover up deficit is unhealthy in itself, the govt's self created massive capital mis-allocation is what it has been trying to resolve in the bargain. This wasn't happening as market sentiments have been down. With announcements about FDI, the markets have lit up and are looking happier and a boost is being felt not only by retailers but also bankers and foreign investors. Other reforms like approving 74% FDI in broad cast services(Tele sports, mobile, TV and sky broadcasting services) and FDI in power exchanges are more like add ons thanks to their narrow impact.

All in all, while Friday rained much awaited reforms on the economy, there is definitely an element of pain in the rains which cannot be missed - sheer timing tells us that these rains have been more self protective than visionary. This is just the first step but not yet reason enough to cheer.