

10th July 2017

Aurum Small Cap Opportunities & Aurum Growth Portfolio 18th Quarterly Update – QE June 2017

GST, possibly the most anticipated structural reform in India, came to pass recently. Barring some initial glitches, we do not expect any major disruption, as feared by many. The benefits of GST (captured in our past updates) will continue to accrue over many years and therefore one should not look at it as a 'steroid' to the economy.

In this quarterly we want to share our thoughts on the concept of **Universal Basic Income (UBI)**, an idea whose time seems to be coming sooner than later. Like GST, as and when implemented, UBI would be a game changing social – economic reform in India.

Preamble - Automation/AI will challenge traditional jobs

You would recollect, in our quarterly update of *September 2015*, we had highlighted how **tech automation** (software automation) was disrupting software industry by rapidly shrinking the need for entry level coders, testers and infrastructure management professionals. Unfortunately, this is not confined to only the IT sector. Jobs in diverse sectors like manufacturing (organized & unorganized), law, financial service, are all grappling with automation and artificial intelligence. In fact, we are approaching a labor market in which entire trades and professions can shrivel to nothingness in the next 10 years timeframe. In such a situation, India's so called demographic dividend can turn into a demographic bomb!

In the coming years, emerging trends will create jobs in entirely new areas such as renewable energy, old-age care, entertainment, etc. or for new skill set like AI, data analytics, cyber security, etc. Traditional jobs, whether for educated, semi-skilled & unskilled segment of population, will be challenged by automation. Under these circumstances, *specific to the bottom of the pyramid population, is the aspect of livelihood preservation.*

Universal Basic Income (UBI)

The paramount question then is to how to protect the most vulnerable segment of population from the downside of this new industrial wave, particularly in India. We believe, the long term answer is in *education, re skilling and in providing universal basic income (UBI)*, till the really poor come up to a certain threshold of economic wellbeing.

Thus, **UBI** can be defined as economic support providing 'basic income security', instead of subsidy or job guarantee, till a household reaches certain economic status.

The Journey from Subsidy to DBT to UBI

I. Subsidy (and other welfare schemes)

In India, government subsidy applicable to food, education, fuel or fertiliser gets triggered when a person decides to consume and pay for it. This implies that the person should have the capacity to pay for it ab initio! At the very bottom of the pyramid, the ability to pay now or even pay less is often non-existent.

Given hereunder is a table highlighting the current central government subsidy program in India and the approximate spend across different segments.

Table I - Central Government Subsidy

Rs Cr	FY15	FY16	FY17
Food (PDS)	1,15,000	1,24,000	1,34,834
Fuel	60,270	30,000	26,947
Fuel - LPG		22,000	19,802
Fuel - Kerosene (PDS)		8,000	7,144
Fertiliser	72,970	72,968	70,000
Interest Sub	8,312	14,903	15,523
Others	1,631	1,520	3,128
Total	2,58,184	2,43,392	2,50,432

Source: Gol website

As is evident from Table I, central subsidy at ~INR 2.5 lac crore has remained largely stable over the last 3 years. Food's contribution to the subsidy bill has gone up to 60% from 45% in FY15. The corresponding decline in fuel subsidy can largely be attributed to lower crude prices.

The aforesaid subsidies are paid out via a mammoth, corrupt & inefficient Public Distribution Service (Food & Kerosene) or through inept state government bodies leading to diversion of subsidies away from intended beneficiaries. Examples of the same are diversion of LPG for commercial purposes and fertiliser sales across the border.

UBI can be defined as economic support providing 'basic income security', instead of subsidy or job guarantee, till a household reaches certain economic status.



Total estimated savings through application of DBT is estimated at ~ INR 20,000 cr in FY17 and ~INR 57 cr, cumulatively since FY14

MNREGA

Similarly, we have the rural employment guarantee scheme (MNERGA) wherein ~INR 60,000 cr (USD 9 b) is being spent annually, of which ~70% is on wages, ~25% on material and ~5% on administration. It is speculated that this too is plagued by large number of phantom beneficiaries and non-existent asset creation. However, over the last few years, efforts have been made to link the beneficiaries with their Aadhar Card and minimise the misuse.

Table II – MNREGA, Rural Employment Guarantee Program

	FY15	FY16	FY17
MNREGA, Rs Cr	36,025	44,002	58,327
No. of Beneficiaries, Cr	6.2	7.2	7.7

Source: Gol website

Collectively, Subsidies & MNERGA account for ~INR 3.1 lac crore (USD 50 b) of annual spend. It would not be out of place to assume that at least 20% of this spend gets misused or misdirected. This, if saved, can translate into potential annual savings of ~INR 60,000 cr (USD 9 b), annually! Realising that the massive corruption and rent seeking can be minimised & eliminated through Direct Benefit Transfer (DBT), based on the technology infrastructure of JAM (Jan Dhan, Aadhaar & Mobile), Government has initiated DBT in some programs and is doing pilots in many others with the idea to roll it out countrywide in a phased manner.

II. Direct Benefit Transfer

DBT is a delivery mechanism for government to effectively deliver benefits, grants & subsidy, directly to the beneficiary and in the process, reduce leakage. Further, this can also be used to provide relief in special situations and generally to the more deserving section of the population, through programs such as rural employment scheme, fuel subsidy, rural housing, pension, etc. While DBT benefits are myriad, the most obvious ones are as listed below:

- a) **Fiscal savings** – As per reports, through application of DBT, government has seen significant savings in MNERGA and PAHAL (LPG) in FY17. Cumulatively, they are adding up to meaningful figures, as given below;

Table III

	Rs Cr.
FY17 Estimated savings from MNREGA	8,740 (USD 1.3 b)
FY17 Estimated savings from PAHAL (LPG)	8,185 (USD 1.25 b)
FY17 Total estimated savings via DBT	20,000 (USD 3 b)
Cumulative estimated savings via DBT (since FY14)	57,000 (USD 8.5 m)

Source: Various Reports & NRC workings

If a family of 5 were to receive INR 4200 per month (~INR 50000* pa) as UBI, it would translate into a bill of ~INR 2,40,000 cr (~USD 37 b). This is more or less equal to current central subsidy and MNERGA bill, less fertiliser subsidy {2,50,000+58,000-70,000}. Thus, theoretically, UBI is a possibility without upsetting fiscal deficit discipline.

- b) **Root out systemic corruption** – The larger impact of DBT would be to root out corruption and a systemic cleansing of the fabric of the country. This would mean effective dismantling of legacy & archaic systems such as PDS. Similarly, direct transfer of payment under MNERGA and other benefit schemes would eliminate intermediaries and commission agents who currently thrive as rent seekers by virtue of their power to stop, deny or delay the benefit to the beneficiary.

III. Universal Basic Income

Owing to automation and other technological innovations, it would be difficult for any country to keep creating jobs for the masses, especially unskilled or semi skilled and of economically weak backgrounds. We believe sooner than later, in some form or shape, UBI will make its appearance in the Government's social welfare programs as a natural progression beyond subsidy & DBT. This will take place on account of the following factors:

- a) **Individual choice** - While implementation of DBT has significant fiscal and institutional integrity benefits, it does not give the 'element of choice' to the beneficiary or gives 'limited choice', at best. The question to be asked at this point of time is, are we getting ahead of ourselves by discussing 'individual choice' when significant % of population is struggling at subsistence level? A short answer is, we should, because *Choice is a natural progression of well-being and the paramount right of citizens*. As society evolves economically, socio economic choice becomes paramount and decides the direction of the country.
- b) **Not fiscally imprudent** - As per Gol figures, 20% of the population or 4.8 cr families are below poverty line. Assume, a family of 5 were to receive INR 4200 per month (~INR 50000* pa) as UBI, in lieu of aggregated benefits or subsidy. It would translate into a bill of ~INR 2,40,000 cr (~USD 37 b). This is more or less equal to current central subsidy and MNERGA bill, less fertiliser subsidy (Ref Table I & II, {2,50,000+58,000-70,000}). Thus, theoretically, UBI is a possibility without upsetting fiscal deficit discipline. However, realistically speaking, we are some distance away from the same and implementation will require significant political will.



UBI transforms a passive recipients of government benefits to active decision makers about their diet, education, health and other goods & services.

As GST is likely to change the economic fabric of the country, we believe, UBI has the potential to dramatically fast forward change in the social-economic fabric of the country!

Benefits of UBI

- a) **Income security** – Consumption based subsidy assumes that the beneficiary has the ability to pay upfront and claim benefits either at the time of payment or later. This might not be the case for some segment of the population. On the other hand, UBI gives the beneficiary household room to 'breathe economically' and thus make prudent decisions over the mid to long term. This also enables nurturing of entrepreneurial instincts, beyond the immediate concern of day to day existence. UBI is thus also about mental & physical well being and support to stay above economic fragility.
- b) **More options, better life** - When there is assured cash flow at specific intervals, the beneficiary will have economic comfort to be able to exercise choice regarding diet (more items like pulses, eggs, milk, etc), education (private or public school), health (public or private), investment (bank, insurance, house). This would have an overall beneficial impact across socio economic spectrum. A welcome scenario, wherein the passive recipients of government benefit emerge as active decision makers about their diet, education, health and other goods & services.
- c) **Empowerment of women** - There is risk that some households will misuse this cash in social evils like alcohol, tobacco or gambling. For this government can make the eldest women in a household target beneficiary for UBI cash transfers. This step is likely to empower women.
- d) **Exit of government from legacy programs** – The eventual winding up of such legacy programs like PDS, MNEGA, etc., would be most welcome.

Instances of UBI

The state of Alaska in USA, has oil revenue/ royalty, which it puts in a fund. This is then distributed as a basic income called Permanent Fund Dividend. This money is distributed to all Alaskan residents as an annual dividend that is ~\$1000 per person. For a family of 5 it works out to \$5,000 and can be fairly meaningful even by US standards. Similarly, Iran also has experimented with UBI with largely positive outcome. One underlying factor with both these geographies is that they are resource rich with sparse to middle density population. Unlike India, which is a densely populated country.

Conclusion

At the outset, we wish to humbly submit that though our assumptions about UBI are simplistic, they are not unrealistic. Theoretically, UBI vs subsidy & employment guarantee maths add up well and UBI can be a possibility in the not so distant future. Practically, we are some distance away from the same and implementation will require significant political will. But then, 5 years ago, who would have anticipated rapid roll out of DBT either!

As GST is likely to change the economic fabric of the country, we believe, UBI has the potential to dramatically fast forward change in the social-economic fabric of the country!



Conclusion

As we write this, everybody is expecting a correction. However, most are scared of being left out of a possible upside if they were to liquidate their investments or sit on the sidelines. Such is human greed. At NRC, we do not take market or cash calls. In other words, we do not invest or divest with an eye on what other market participants are doing or how the market is performing. We invest and divest one stock at a time, on merit & valuations. It is a process driven portfolio management system, with buy and sell price discipline. We continue to adhere to the same process and discipline, as in the past.

Warm regards,

Sandeep Daga

For further information, please contact:

Nine Rivers Capital Holdings Pvt. Ltd.

511-512, Meadows, Sahar Plaza, Andheri - Kurla Road, Andheri (East),
Mumbai - 400 059 India.

Tel: +91 22 4063 2800 • Fax: +91 22 4063 2801 • Email: info@nineriverscapital.com

Disclaimer:

Certain information herein may be based in part on hypothetical assumptions and past performance. Past performance is no guarantee of future performance. The actual performance may differ materially, from that set forth in the attached information. Nothing contained herein shall constitute any representation or warranty as to future performance or business strategy of Aurum Small Cap Opportunities & Aurum Growth Opportunities (A PMS offering from Nine Rivers Capital Holdings Pvt. Ltd). Any opinions or statements expressed herein are subject to change. The information contained herein does not, and does not attempt to, disclose all of the risks and other significant aspects of entering into any particular transaction.

Under no circumstances is this information to be used or considered as an offer to sell, or solicitation of any offer to buy, any security. The information contained herein is not to be used for any other