# Opportunity taken

## Why the President's address to Parliament on Jan 31 will be as important as the interim Budget to be presented by the finance minister

RAISINA HILL

AK BHATTACHARYA

A new session of Parliament will begin on January 31, just about three weeks after the conclusion of its winter session. The winter session of Parliament had begun on December 11, 2018. After 17 sittings spread over almost a month, the Lok Sabha was adjourned sine die on January 8 and the Rajya Sabha too was similarly adjourned on January 9.

Significantly, the President prorogued both the houses on January 10, thereby signalling that Parliament was no longer in session. For the government, this was a political necessity. The Muslim Women (Protection of Rights on Marriage) Bill, 2018, also known as the triple *talaq* bill, is yet to be passed by the Rajya Sabha. The ordinance that was promulgated to enforce the provisions of this bill will lapse on January 21. The government could not have repromulgated the ordinance if the winter session of Parliament had not been prorogued.

This is also the reason why the Narendra Modi government did not follow the path that was taken by the Atal Bihari Vajpayee government in 2004 in a similar situation.

That was also an election year. The winter session of Parliament then had begun on December 2, 2003. After a few sittings, the Lok Sabha was adjourned sine die on December 23. The Rajya Sabha too was adjourned sine die on the same day.

But the winter session of the two houses was not prorogued. In other words, Parliament had remained in session. Using this provision in the rules, the Lok Saba secretary-general issued a notice on January 20, 2004 to resume the session of the lower house from January 29. Similarly, the Rajya Sabha was reconvened on January 30.

This gave rise to a big controversy. Parliament debated if its rules were violated by not having the President deliver an address to both the houses at the start of the first session in a new year. The government argued that the session that began on January 29 and 30, 2004 was not a new session, but only a second phase of the winter session that had been adjourned sine die on December 23, 2003. This was challenged in the court also, but the petition that not having the President address the session on January 29 violated the Constitution was dismissed.

What did the Vajpayee government achieve by treating the January 2004 session as an extension of the previous one? It obviated the need for the President to deliver an address to both houses of Parliament outlining the government's agenda. Instead, Finance Minister Jaswant Singh presented the interim Budget on February 3, 2004 and a few days later, on February 6, the Lok Sabha was dissolved, paving the way for the general elections in May 2004. The President addressed a joint session of Parliament that year only after the general elections — on June 7, with a new government in place.

The Modi government's decision to prorogue the sessions of both the houses of Parliament may have been driven by another consideration. The Parliament session to begin from January 31, 2019 will be treated as the first session of a new year. This will require the President to deliver an address to both the houses of Parliament. This will be an opportunity for the government to convey through the President's speech its programmes for the coming year. With general elections to be held in the next few months, this is an opportunity that the government would not have liked to miss.

The forthcoming session of Parliament will also be keenly followed because of the interim Budget that Finance Minister Arun Jaitley is scheduled to present on February 1. Jaitley's latest statement that he would frame the interim Budget keeping in mind the current economic reality has sparked speculation that he may announce new policies and a fresh package of tax incentives for individuals.

With no Economic Survey before the presentation of the interim Budget, an official assessment of the state of the economy during 2018-19 will have to await the presentation of the full Budget after the general elections are held and a new government is in place. As it happened in 2014, the Survey to be tabled in Parliament after the general elections will be able to present a complete picture of the economy in 2018-19 as all relevant data will be available by then.

The President's address to Parliament on January 31, therefore, assumes greater importance as that would contain the government's report card on the state of the economy. It will be no less important than the interim Budget announcements that Jaitley will make a day later.

# How solvent is India's new insolvency law?

## Lenders will have to wait longer for bad loan resolution unless the loopholes are plugged

BANKER'S TRUST

TAMAL BANDYOPADHYAY

ILLUSTRATION BY BINAY SINHA

In August 2016, the chief executive officer (CEO) of a large bank celebrated the arrival of the Insolvency and Bankruptcy Code (IBC), the new bankruptcy law of India. The jubilant boss of the bank, laden with a mound of bad assets, asked one of his colleagues how many days it would take to settle a bad loan under the new law. The banker's response was 1,800 days, 10 times the law actually stipulated! Needless to say that this cynicism was not appreciated.

By now, looking at the progress of the single-window insolvency and bankruptcy resolution process which is expected to minimise the cost and time for liquidation and resolution of bad assets, the (now retired) CEO must have changed his opinion and renamed his colleague "Cassandra".

Under the new law, ICICI Bank filed the first case against a steel products maker which had ₹955 crore debt in September 2016. Since then, at least 10,000 cases have been filed but there are just 13 benches of the National Company Law Tribunal (NCLT) that hear such cases. Any default above ₹1 lakh can be dragged to NCLT by financial creditors, operational creditors and even the corporate borrowers.

Woefully inadequate infrastructure is just one of the many reasons why a case is not settled within 180 days and even 270 days as envisaged by the law. Meanwhile, 28 defaulters against which bankers moved the insolvency court in December at the instance of the Reserve Bank of India (RBI) have been celebrating the first anniversary. Forget settlement, not all the cases have even been admitted at the NCLT.

The RBI in June 2017 listed 12 defaulters against whom it had wanted immediate bankruptcy proceedings to be invoked. This was followed by another list of 28 defaulters in August 2017. Together, the two sets account for around 50 per cent of the ₹10 trillion bad debt in the Indian banking system.

Recently, during a court hearing, an interesting observation was made in relation to a case where the defaulter moved the court. "When do we give capital punishment to someone? For a premeditated murder — a heinous crime. Often a contract killer does this just for money. If the person is hanged what happens to his family — his innocent wife and school-going children who are not even aware of the crime? Should we treat them as outcast or rehabilitate them? Can business failure be treated as more heinous than a murder?"

These cases will continue to be heard at the courts but such an observation gives a new dimension to the law which, through an amendment, prohibits relations of a bank defaulter from bidding for such assets. We can expect the process of fine-tuning the law to continue for the time being.

Once a defaulter is identified, a committee of the creditors (CoC) appoints resolution professional (RP) to supervise the case. In the next stage, the information memorandum is prepared and the so-called expression of interest is sought from the prospective bidders. After checking the eligibility of the bidders and evaluating the bids, the CoC goes to NCLT.

Typically, the CoC always gives priority to the interest of the lenders over the operational creditors, such as suppliers of capital goods, original equipment manufacturers, maintenance vendors and others. A company going for liquidation is fine but when the plan is to sell it as a going concern with resources to continue operations, the interest of the operational creditors has to be taken care of. Otherwise, the assets will become junk — and that's what has been happening in many cases.

Last week, the Supreme Court reserved its judgment in petitions moved by operational creditors challenging the validity of the IBC, and alleging that discriminatory treatment was given to a certain class of operational creditors and the law was protecting the rights of only financial creditors.

For a power plant, the moment the liquidation process is invoked, the power purchase agreement and fuel supply pact lose their validity and in their absence no bidder will come forward.

While Indian insolvency law is more aggressive than most developed markets, unlike in the US and some other countries, here the law does not have any scope for preservation of the assets. This means once the bankers move against, say, a steel defaulter, the machinery of the factory may disappear with no security guard in sight.

Besides, the RP enjoys no immunity. Recently, the police filed an FIR against an RP who was overseeing the insolvency proceedings of a company in West Bengal which had not deposited the provident fund of its employees with the authorities.

Finally, no one knows when the bidding process for an asset up for sale ends as even the losers can make fresh bids and new bidders can join the fray. Allowing new bids after sealing the process helps the price discovery but it leads to inordinate delays and kills the sanctity of the process. The judiciary seems to be in favour of value maximisation than early resolution.

Also, at least one successful bidder for more than one asset, has not been able to put money on the table!

The "Cassandra" recently told me IBC is just marginally better that DRTs (Debt Recovery Tribunals) set up after the passing of Recovery of Debts due to the Banks and Financial Institutions Act (RDBBFI) 1993 which miserably failed to resolve the bad disputes. Around 1,00,000 cases have been pending at three-dozens-odd DRTs across India. A World Bank estimate says the old law used to take average 4.3 years to resolve insolvency and recovery was 25.7 cents for every dollar. The first instance of a defaulter being dragged to a DRT — Mardia Chemicals Ltd — is a classic case study illustrating how helpless the lenders are.

IBC is emerging as an ideal tool to threaten the defaulters and bring them to the discussion table. If the lenders want to use it, the wait could only get longer unless the loopholes are plugged and the defaulters denied the normal legal course. Of course, if the defaulters are not allowed to move courts, the IBC runs the risk of being dubbed as draconian.

*The columnist, a consulting editor with Business Standard, is an author and senior adviser to Jana Small Finance Bank Ltd. Twitter: @TamalBandyo*

## CHINESE WHISPERS

### Lack of funds

*Sweksha Anudaan* is a voluntary grant service that was initiated during the Digvijay Singh government in Madhya Pradesh. The budget of the grant amounted to ₹2 crore and was meant to be given to people from economically weaker sections to help them tide over their medical expenses. Former Madhya Pradesh chief minister Shivraj Singh Chouhan had increased the grant amount several times during his tenure. The corpus had grown to ₹120 crore last year, which Chouhan spent in the first six months of his tenure the year before, thinking it would bring some votes to the party in the assembly elections. However, they lost. Now when the new Chief Minister Kamal Nath decided to keep the scheme running after taking oath, there were no funds to be given out. Sources said Nath had to arrange funds on his own to disburse it to the general public.

### Season of change

January is turning out to be a month of promotions and transfers in the central government corridors. Before the proverbial bell rings for the code of conduct to set in, the government officers are getting clearances for training programmes abroad, which would have otherwise come through in April and May. Further, junior posts are being filled with several orders in bulk issued from end of December. Most of them are ad-hoc since the regular ones would have come through only in April or May.

### Laws are laws

The fear of law and punitive action does not spare even advocates. Last week, during a hearing against a global car maker, a young counsel appearing for the company had a harrowing time when the four-judge bench of the National Green Tribunal (NGT) initially refused to give them even a minute's time to comply with the past orders. As the young lawyer started to explain the company's stand and sought seven days to deposit the fine, the NGT chairperson threatened to order the arrest of its managing director right away. The lawyer immediately relented and said they would deposit the amount within 24 hours.

# The fog of fiscal finances

## A string of new expenditure is clouding India's fiscal future

PRANJUL BHANDARI

A fog has set in over New Delhi, and it is not just weather related. The fiscal outlook for the medium term seems unclear.

It began in 2018, when the much-needed new fiscal rules (Fiscal Responsibility and Budget Management — FRBM) were enacted in Parliament. They make public debt the main anchor of the fiscal framework. They stipulate that overall (centre plus states) debt should not exceed 60 per cent by the end of FY25, down from over 70 per cent now.

So far, so good.

The inconsistencies began when, around the same time, several new spending plans with substantial costs were announced – a string of farm loan waivers, bank recapitalisation bonds, a new healthcare scheme, and higher minimum support prices (MSPs). Over 2018, these spending plans were scaled up further — more farm loan waivers, more direct farmer income support measures, and additional bank recapitalisation bonds.

Don't get us wrong. We are not against these expenditures and that is not the focus of this oped either. We are just pointing out that the new debt targets will become hard to meet under the weight of these new spending pressures.

Our debt analysis suggests that to meet the public debt-to-GDP ratio target of 60 per cent, the centre and the states would need to jointly double their efforts on fiscal consolidation: Lower the overall fiscal deficit by 1.4 per cent of GDP over the next seven years vs the 0.7 per cent of GDP decline in the past few years. However, even that may not be enough: Once we include the new spending commitments, even a doubling of effort is insufficient.

Missing FRBM targets could have implications for the debt market, sovereign ratings, and economic growth and stability. No one seems to be acknowledging this as yet. And that's perhaps reason enough that someone should bridge the gap before it is too late.

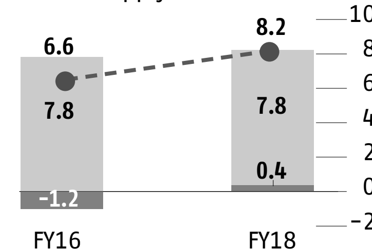
How are things looking currently? Even though the central government may meet the 3.3 per cent fiscal deficit target for this year, it will be painfully done, requiring sizeable expenditure cuts and relying on a higher interim dividend from the Reserve Bank of India (RBI) and dipping into the GST compensation pot which was meant to be locked away for five years.

State governments do not seem to be consolidating their deficits either. They are likely to see 22 per cent growth in borrowings in FY19. The state government bonds (also known as SDLs) spreads over the central government bonds, which reflect the market's perception of the risk associated with SDLs, have risen quickly over the last few weeks.

Looking closer shows that markets are feeling the heat from too much public sector (central and state government and public sector undertakings) borrowing. The "net supply" of paper (after accounting for the regulatory demand from RBI's Open Market Operations (OMO) purchases and SLR requirements) rose sharply in FY18.

**GOVERNMENT BORROWING**

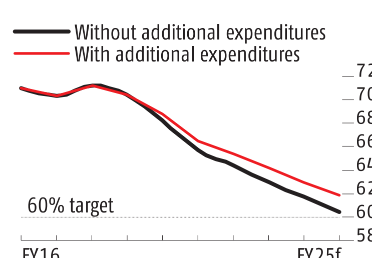
The "net supply" of government paper has risen sharply %GDP




Note: Total supply: Gross centre and state borrowing + PSE borrowings. Regulatory demand: RBI's net OMO purchases + incremental SLR demand by banks. Net supply = Gross supply – Regulatory demand Source: CEIC, RBI, HSBC

**PUBLIC DEBT DYNAMICS**

As soon as we include some of the additional expenses, the 60% debt target becomes elusive %GDP




Note: Scenario II assumes that both the centre's and states' FD goes to 2.5% by FY25 , and there are additional burdens on deficits or debts of both on the horizon
Sources: Budget documents, RBI, CEIC, HSBC estimates

One could argue that some of these fiscal pressures will abate once the national elections are over. The country will comfortably get back on to the new FRBM track. However, look closer and you will find that many of the spending plans are more permanent in nature. And, at any point in time, a handful of India's states are close to an election.

And yet, there may be some hope of meeting the debt target. GST revenues could rise quickly over the next few years. And some believe that a sizeable "excess" dividend from the RBI could help the government finances too. How real are these hopes?

On the GST front, the ask is too high (though not impossible). By our calculations, tax revenues would have to rise faster than nominal GDP growth for the next six years to meet the debt target in the face of higher spending commitments.

Calculations of the RBI's "excess" capital (if any) are fraught with definition issues and are sensitive to the assumptions used. Even if some "excess" is identified, every channel of transferring the funds to the government will come with some uncertainty. For example, a larger transfer of future profits, even if mandated, may not guarantee a steady stream of revenue each year. A transfer of some stock of "excess" capital could stoke inflation, calling for tighter monetary policy, which may ultimately hurt private enterprise.

At the heart of all this is a vacuum. There is no agency in the government that looks comprehensively at both the central and the state fiscal costs and revenues, relating them to the fiscal rules that the country has enacted. Without such counsel, the government risks making sub-optimal policy decisions.

The FRBM committee report of 2017 called for such an institution, naming it the "Fiscal Council", and even highlighted the key roles it could play. The idea was to create an institution that provides clear analytical inputs and works with the government to deliver better fiscal outcomes.

One thing seems clear amid all this haze — it's time the Fiscal Council was set up.

*The writer is chief India economist, HSBC Securities and Capital Markets (India)*

## LETTERS

### Miles to go

It was interesting to read the report by Anup Roy " Das favours flexible policy objectives" (January 19). The speech delivered by the Reserve Bank of India (RBI) Governor at the Vibrant Gujarat Summit is nothing extraordinary. It neither spells out the road map for new dynamism nor any noticeable policy shift by the central bank. It aims at bringing the central bank's actions in alignment with the expectations of the government: Mainly a reduction in interest rates with the hope that it will spurt investments and shows the bank's subservience to the government's policies.

The demand by industrialists for a sizeable reduction in interest rates in the February policy announcement is nothing unexpected. One wonders whether they would be satisfied even with a zero interest rate. As far as cleaning up the balance sheets of the public sector banks is concerned, the less said the better. Further, a marginal reduction in the non-performing assets situation is no matter to rejoice, there is miles to go. Is Mr Das listening?

**C V Subbaraman** Mysuru

### A tightrope walk

This refers to Anup Roy's report "Das favours flexible policy objectives" (January 19). In his maiden speech as the RBI Governor, Shaktikanta Das has asserted the RBI's mandated roles without being controversial in expression. As brought out in the report, India's central bank has all along been playing a proactive role in promoting economic growth and financial inclusion by dovetailing its policies in consonance with the government of India's (GOI) policy prescriptions.

This occasionally came into conflict with the performance of RBI's core functions with regard to maintaining price stability and regulation of institutions in the financial sector. With improved transparency in communication, sometimes media and vested interests inflated the differences in policy perceptions between the GOI and the RBI out of proportion.

Viewed from this angle, the clarity in policy perceptions visible in the RBI governor's speech is soothing and comforting. He is fully aware of the need to balance the twin objectives of economic growth and price stability and will need unreserved support from the GOI. The government will need to follow the required discipline on the fiscal policy front. It is going to be a tightrope walk in an election year for both the finance minister and the RBI governor. Unfortunately, both cannot afford to threaten to 'walk alone'.

**M G Warrier** Mumbai

Letters can be mailed, faxed or e-mailed to:
The Editor, Business Standard
Nehru House, 4 Bahadur Shah Zafar Marg
New Delhi 110 002
Fax: (011) 23720201 · E-mail: letters@bsmail.in
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## HAMBONE

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# Review angel tax

## Start-ups and investors need more than easing of norms

The new notification easing norms for exemption from the so-called angel tax under Section 56 (2) (viiib) of the Income-Tax Act with retrospective effect from April 2016 will afford some relief to many start-ups and investors. It is encouraging to see that the government has taken note of the many objections raised. The Central Board of Direct Taxes (CBDT) is mandated to evaluate and respond to each application within 45 days. This is a welcome development, though some key issues still remain. The law itself is inconsistent with the realities of start-up investing. Though some norms have been eased, the procedure to apply for exemption still remains cumbersome, and government officials retain a great deal of discretion in either clearing exemption or raising tax demands. Moreover, the exemption limit is low, since it applies to start-ups under ₹10 crore. The definition of an investor remains rigid and the new clarifications also appear silent on the recently mooted concept of an expert committee, which could study eligibility criteria for exemption.

The essential problem with the angel tax is that it revolves around the "fair value" of a new business. The tax demand could be levied if an assessing officer believes that the equity of a new business has changed hands at above "fair value". Unfortunately, almost by definition, fair value is impossible to ascertain for an unlisted new business. A new business has no track record and it may be light on assets as well, especially if it is in the services sector. Investors will back a new venture after valuing it in terms of what they think of the growth prospects. It is impossible to judge, except with the benefit of hindsight, whether any given valuation is fair or not. The new procedure to seek exemption involves an application made by the start-up to the CBDT, via the Department of Industrial Policy & Promotion (DIPP). The DIPP, therefore, has the discretion to recommend an exemption. The process of application has been streamlined but an unrealistic amount of personal information must still be provided. The investors must be accredited and they must share their source of funds with the start-up seeking an exemption. Most investors would be wary about sharing such information. Hence, this is a stumbling block that could mean few applications for exemption. An investor is defined in the new notification as somebody with a minimum net worth of ₹2 crore and this investor must have submitted an income tax return of at least ₹50 lakh at least once.

So the essential problem — the unclear definition of fair value — remains. Start-ups and angel investors will continue to struggle when it comes to explaining how they have valued a given business. The law was created in order to prevent money laundering through the medium of a shell company floated as a start-up. This is an understandable objective. But the concept of "fair value" is not a suitable way to judge if money laundering is occurring. Nor is it fair to burden a legitimate business with the task of ascertaining where investors source funds. The vast majority of start-ups are legitimate. The particular Section of the I-T Act, introduced in 2012, taxes any investment made by an Indian entity in an unlisted Indian company above fair market value as income. As long as it remains, it will continue to scare away legitimate entrepreneurs and investors. It's time to review it.

# The 10% question

## Mandating quota for private institutions makes little sense

India's higher education system is plagued by a host of problems, ranging from inadequate facilities to sub-par faculty, as a result of which very few make it to the top of credible global rankings. Indeed, surveys have shown that the bulk of Indian graduates are barely employable. Mandating a 10 per cent quota for economically weaker sections (EWS), defined generously as a family with an annual income of less than ₹8 lakh, is likely to exacerbate this crisis. It can be argued that the government is entitled to implement this quota in centrally-funded institutions, though the wisdom of doing so is open to debate, and has created consternation across resource-starved public universities. But to mandate the quota for private sector institutions — both aided and unaided ones — which the government plans to activate through a Bill in the upcoming session of Parliament, is to destabilise the entire eco-system for higher education in lasting ways.

Over the past two decades, the private sector has expanded its presence significantly in higher education, so much so that the earlier shortage of university seats for school-leavers has diminished. Though their quality is admittedly variable owing to an inefficient regulatory environment, these institutions have widened the market for higher education. Those that are autonomous do not have quota restrictions, while those affiliated to state or central universities or institutions of higher education do. Both types of institutions will now find themselves being forced to adjust, within a space of a few months, to admitting students under the EWS section. For both affiliated and autonomous institutes this expansion will mean adding seats and related facilities, both of which will entail a cost.

As with publicly funded and aided universities, which, too, will not be receiving money to expand their admissions to accommodate the additional quota, private institutions will probably be forced to raise fees from full fee-paying general quota students to cross-subsidise those from the EWS category. Some level of cross subsidy does occur because most private institutions of higher learning offer scholarships, subsidies or discounts for economically weaker students. The point to stress, however, is that these incentives are merit-based. An EWS quota will create a non-level playing field between such genuine merit scholars from disadvantaged backgrounds and those who enter via the quota.

In 2005, an 11-judge Bench of the Supreme Court had ruled out quotas for scheduled castes, scheduled tribes and other backward classes in private unaided colleges. The apex court did, however, allow a 15 per cent quota for non-resident Indian students but provided the higher fees that were charged from such students were used as a cross-subsidy for poorer students. This provides a handy blueprint if the government is truly concerned about social empowerment. Expanding the range of merit-based scholarships — and the government already has a range of such incentives — would ensure that those who cannot afford high-quality education gain access to it and, more importantly, are able to complete a degree. Without providing additional funds for public universities and imposing a blanket quota on private ones, it is difficult to escape the view that this provision is focused on electoral gains rather than truly empowering economically weaker students.

ILLUSTRATION BY AJAYA KUMAR MOHANTY

# Development strategy & Budget

## Fiscal prudence, compliance and simplification — however desirable — are too narrow as a focus for policy design

On February 1, 2019, the finance minister will present the final Budget of this administration. It should be an interim Budget as this is an election year and the regular Budget for the 2019-20 should be presented after the general election. However, Arun Jaitley will use this occasion to present a report card on the management of fiscal policy over the past five years. Judging by recent pronouncements, in a departure from established practice for pre-election budgets, he will also use the occasion to make some announcements of expenditure proposals and policies designed to win electoral support.

NITIN DESAI

The report card on fiscal policy will focus on the goals announced in the two key policy statements on medium-term fiscal policy and on fiscal policy strategy that form part of the Budget documents. Looking at the text of these statements over the past several years it would appear that the primary goals of fiscal policy are a steady reduction in the fiscal deficit as a proportion of GDP, a rise in the tax/GDP ratio, simplification of the tax structure and improved compliance. The Budget this year will undoubtedly present suitably calculated numbers to show that the finance minister's five budgets have delivered on these goals. The question that needs to be asked is whether these goals are enough.

The tax/GDP ratio is a crucial component of grand development strategy. But there is little discussion on the pace at which this ratio needs to rise. Pressures for public spending on social security, health, education, and urban infrastructure will increase as the economy industrialises and urbanises and as rising prosperity raises people's expectations of the quality of public services they expect. Hence a medium- and long-term assessment of desirable levels of public spending should be part of the publicly articulated fiscal strategy. These public spending responsibilities devolve on the Centre, the states and local authorities. Hence the long-term vision for fiscal devolution must also be part of the strategy.

A long-term vision for public spending can also help in a constructive use of short-term fiscal compulsions. A fiscal stimulus required for macroeconomic reasons can be an opportunity for supporting long-term development strategy. For instance, when a fiscal stimulus was required after the 2008 global crisis China raised spending by 3 per cent of GDP and South Korea by 5 per cent of GDP to accelerate research and development of industries based on technologies such as artificial intelligence, smartphones, solar panels, electric cars and wind turbines. This is now providing them with a strong capacity to challenge Western technological dominance. We, on the other hand, used the post 2008 fiscal stimulus to simply scale up spending on established welfare-oriented programmes.

Development strategy does seek to narrow income inequalities. Fiscal policy affects income distribution mainly through the direct tax rate structure and the concessions and subsidies in the Budget. The stated policy of the government on direct taxes is "to broaden and deepen the tax base while maintaining a moderate tax rate and gradually phasing out exemptions." The basic 10-20-30 per cent rate structure of the income tax has been around for over two decades now and has replaced the more progressive tax structure that prevailed before the liberalisation of the nineties. Over this period personal income tax collections as a percentage of non-agricultural GDP rose from around 2 per cent in 2003-04 to 3 per cent into 2013-14 and further to around 3.5 per cent during the tenure of the present administration.

This does not suggest any dramatic improvement in compliance because of demonetisation as has been claimed by some. Moreover, the impact on income redistribution would be minimal even if all of the income tax collection were available for transfers to the poor. The fiscal concessions given to the taxpayers, the generous treatment of dividends and capital gains and the total absence of an inheritance tax suggest that neither this nor previous administrations have used the tax system for redistribution. The only instruments they have sought to use for this purpose are price subsidies and welfare programmes.

Sudipto Mundle and Satadru Sarkar of the National Institute of Public Finance and Policy (NIPFP) have estimated that subsidies which cannot be justified on redistributive grounds constitute about 6 per cent of GDP and the tax concessions about 4 per cent to 5 per cent of GDP in 2015-16. Income supplements, and subsidies on merit goods and services like food, basic education, health, water supply and sanitation, amount to only about 2 per cent of GDP. There is now some talk of replacing the product and service-specific subsidies with direct income transfer and we may well see a beginning in this direction in this year's Budget. But it will not make much difference to income distribution unless the unmerited subsidies and the direct tax concessions are drastically reduced, and income supplementation raised well above the 2 per cent of GDP that is today the extent of the fiscal redistributive effort.

The other dimension of fiscal strategy that requires attention is calibrating taxes and subsidies to correct differences between social and private benefits and costs. One example of this is free immunisation provided for communicable diseases, which can be justified on the grounds that reducing the pool of infection extends the benefit beyond the immediate beneficiary to the community at large. Another example is the ₹400/tonne coal cess, which can be justified as a tax to cover the social cost of carbon emission, particularly as the cess is supposed to be used for clean energy. There are many other examples where a differentiation of tax incidence between competing products is desirable for environmental, health or other social grounds, eg plastics vis-a-vis other packaging products.

Pigouvian taxes and subsidies that seek to correct for externalities will inevitably imply differences in the rate of taxation of competing products. This will fly in the face of the commitment to have a single GST rate for all but a few products. The answer may lie in a complementary cess/subsidy structure based on a systematic assessment of the extent of difference between private and social costs and benefits.

Fiscal prudence, compliance and simplification are undoubtedly desirable. But they are too narrow as a focus for policy design. The link between fiscal policy and the grand strategy of development gets lost in this approach. We also need to pay greater attention to the impact of fiscal policy on income distribution and on consumption and production choices that affect matters like environment, sustainability of resource use and health.

*nitin-desai@hotmail.com*

# Lobbying against external benchmark begins

After 20 years of allowing the open abuse of floating rate loans, on December 5, the Reserve Bank of India (RBI) announced that beginning April 1, 2019, banks would have to link interest rates on such loans to an external benchmark instead of using their own internal benchmark. This marks one of the few cases of pro-consumer action taken by the RBI. The RBI claims to strike a balance between banks and consumers, but usually bats for banks.

But lenders aren't giving in so easily. They have started lobbying against the external benchmark, stressing "problems" in implementing the linking of an external benchmark rate to floating rate loans. To put the maximum weight behind their lobbying, bankers usually get a senior official from the government-owned behemoth State Bank of India (SBI), to speak on their behalf. On January 10, Prashant Kumar, deputy managing director and chief financial officer of State Bank of India, wrote an article in this paper, which argued strongly against the new RBI policy.

IRRATIONAL CHOICE

DEBASHIS BASU

It turns out his arguments are rather tangential and mainly advocate retaining the status quo. He wants savers to continue to put money in savings banks at 4 per cent or less, which is very good for banks. He says adjusting the policy rate will not change the lending rate much because only 1 per cent of bank borrowings are currently at the policy rate. Three, current account and savings accounts (CASA) deposits account for 41 per cent of public deposits. Banks pay no money on the current account and an average of 3.5 per cent on the savings account. The rest are time deposits with a fixed interest rate. So, when the policy rate changes, there will be only a small change in deposit rates and thereby in lending rates. He then goes on to complain how the changeover is going to involve time and money, and how banks will make less money so things should continue as usual. The regulator, of course, ought to take a more balanced view including the interests of the consumers. From this perspective, here are two very important issues that Mr Kumar has missed or ignored.

### Arbitrary calculations

The benefit of imposing an external benchmark is not just to make sure that every change in interest rates is transmitted. There are two other important benefits: Making the floating rate calculation transparent and stopping the discrimination between new and old borrowers, which was pioneered by SBI and followed by other banks. To understand the tremendous opacity in floating rates calculations by the banks, look at the RBI's own internal study titled "Report of the Internal Study Group to Review the Working of the Marginal Cost of Funds Based Lending Rate (MCLR) System", headed by Janak Raj.

The report points out that "banks deviated in an ad hoc manner from the specified methodologies for calculating the base rate and the MCLR to either inflate the base rate or prevent the base rate from falling in line with the cost of funds. These ad hoc adjustments included (i) inappropriate calculation of the funds; (ii) no change in the base rate even as the cost of deposits declined significantly; (iii) sharp increase in the return on net worth out of tune with past track record or prospects to offset the impact of reduction in the cost of deposits on the lending rate; and (iv) inclusion of new components in the base rate formula to adjust the rate to a desired level." This simply means that rates were kept artificially high by adopting unfair means, denying legitimate savings to borrowers.

"Variations in the spreads across banks appear too large to be explained based on bank-level business strategy and borrower-level credit risk...spreads charged by some banks seem excessively and consistently large. The analysis suggests that banks spreads arbitrarily changed the spreads for borrowers of a similar quality. While the spread over the MCLR was expected to play only a small role in determining the lending rates by banks, it turned out to be the key element in deciding the overall lending rates. This has made the entire process of setting lending interest rates by banks opaque." This is a malpractice, pure and simple, which an internal benchmark will perpetuate.

### Discrimination against customers

In a grossly discriminatory action, new customers are offered loans at a rate lower than existing (old) customers of similar loans. With an external floater, banks cannot differentiate between a new customer and an old customer, or between the person who has approached the bank to reduce his interest burden and the one who has not. If the rate decreased, it would have gone down for everybody.

Also, each bank, arbitrarily and capriciously, charges borrowers for the favour of reducing the rate. It is clear that a charge to simply reduce interest on a floating rate loan is extortion, but this is exactly what the RBI has officially sanctioned. Under an earlier circular, issued in 2010, banks could not charge customers for changing the rate. In April 2016, the RBI dropped this clause, allowing each bank to charge based on mutual negotiation — where the customer had no bargaining power. If, for no other reason, external benchmarks are critical to improve the much-desired transparency and fairness of the system, since certainly banks won't do it on their own.

*The writer is the editor of www.moneylife.in*
*Twitter: @Moneylifers*

# The art of tech poaching

BOOK REVIEW

JENNIFER SZALAI

A friend of mine says that whenever he walks into someone's home he's tempted to yell out, "Hey, Alexa," or "OK, Google," and order 50 pizzas, just to see if there's a device listening in on whatever gossip he planned to dish out next.

Shoshana Zuboff would undoubtedly get the joke, but she probably wouldn't laugh. In *The Age of Surveillance Capitalism*, she warns against mistaking the soothing voice of a personal digital assistant for "anything other than the exploitation of your needs." The cliché that "if you're not paying for it, you're the product" likens the big tech platforms to elephant poachers, and our personal data to ivory tusks. "You are not the product," she says. "You are the abandoned carcass."

OK, Ms Zuboff, tell me more. It's a testament to how extraordinarily intelligent her book is that by the time I was compared to an elephant carcass, I resisted the urge to toss it across the room. Ms Zuboff, a professor emerita of Harvard Business School and the author of *In the Age of the Smart Machine* (1988), has a dramatic streak that could come off as simply grandiose if she didn't so painstakingly make her case. She says we're living through such "a bold and unprecedented shift in capitalist methods" that even as we encounter the occasional story about Facebook allowing its corporate clients to read users' private messages or the software in Google's Street View cars scraping unencrypted information from people's homes, the American public doesn't yet grasp the new dispensation in its entirety.

So many people take care to calibrate their privacy settings just so, sharing certain things with friends and keeping other things hidden, while their data still gets collected and shared among apps for possible monetisation now or later. Google and Facebook might not call to mind the belching smoke stacks and child labourers of the Industrial Revolution, but Ms Zuboff argues that they're run by people who have turned out to be just as ruthless and profit-seeking as any Gilded Age tycoon. Instead of mining the natural landscape, surveillance capitalists extract their raw material from human experience.

This business model emerged almost by accident. Ms Zuboff describes how Google, in its early days, happened to keep a cache of data byproducts — spelling, click patterns, location — that were produced with each search. It was only after the dot-com bubble burst in 2000 that the company was forced to figure out how to do more than simply provide a free service to its users. It settled on selling advertising, but the advertising would be "relevant" and "targeted," using all the detailed behavioural information Google had collected from users.

"This new market form declares that serving the genuine needs of people is less lucrative, and therefore less important, than selling predictions of their behavior," Ms Zuboff writes. Whatever gauzy sentiments the new kinds of capitalists espouse (or even believe) about building community and democratising knowledge get subordinated to the brute demands of economic survival — hence the relentless accumulation of additional data sources, and the ardent lobbying against government regulation.

Surveillance capitalism has flourished precisely because it fulfills what Ms Zuboff concedes are real needs and desires. Online platforms offer us ways to "ease the complexities of our harried lives." In exchange for surveillance we get convenience, efficiency and social connection.

Google comes in for plenty of criticism from Zuboff, but she is equally scathing about Facebook. (She calls Sheryl Sandberg, who worked at Google before becoming Facebook's chief operating officer, "the 'Typhoid Mary' of surveillance capitalism.") Facebook has learned how to manipulate empathy and attachment in order to increase engagement and make billions. In a document sent to advertisers in Australia and New Zealand, Facebook bragged of its ability to discern exactly when a young person could use a "confidence boost." And then there are the Facebook scandals involving Cambridge Analytica and the Kremlin during the 2016 election, with their deployment of personality tests and viral memes; it's all fun and games until the host of "The Apprentice" becomes president.

Surveillance capitalists like to depict themselves as more socially enlightened than their industrial predecessors, but in Zuboff's reckoning they ask for a lot while giving relatively little back. Their companies operate at "hyperscale": Despite their enormous market capitalisation, Google and Facebook each employ far fewer workers than General Motors once did, even during the depths of the Great Depression. Citing the economic historian Karl Polanyi, Zuboff shows how postwar corporations were expected to offer some sort of communal reciprocity — hiring workers and hiking wages, sharing prosperity rather than hoarding it. The ascendancy of neoliberalism in the 1970s, she says, laid the groundwork for Silicon Valley to promote an extreme form of entrepreneurial capitalism, unencumbered by any substantive responsibility to the communities it purports to serve.

Ms Zuboff can get overheated with her metaphors; an extended passage with tech executives as Spanish conquistadors and the rest of us as indigenous peoples is frankly ridiculous. But then maybe my reflexive discomfort only indicates that I've become acclimated — or "habituated," as Zuboff likes to say — to the world that surveillance capitalists have created. A business model that seeks growth by cataloguing our "every move, emotion, utterance and desire" is too radical to be taken for granted. As Ms Zuboff repeatedly says near the end of the book, "It is not OK"

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**THE AGE OF SURVEILLANCE CAPITALISM**
**The Fight for a Human Future at the New Frontier of Power**
Shoshana Zuboff
Public Affairs
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