Is the IBC losing its effectiveness?

On the contrary, it has the potential to change the behaviour of investors, lenders and borrowers to create a more healthy ecosystem for India Inc

RAISINA HILL

A K BHATTACHARYA

There is a growing concern that the Insolvency and Bankruptcy Code (IBC) has taken a bit too long in resolving cases of corporate indebtedness — much beyond the stipulated outer limit of 270 days. The fear, therefore, is whether the IBC will soon be rendered as ineffective as some of the similar laws like the Recovery of Debts Due to Banks and Financial Institutions Act, 1993, the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, the Sick Industrial Companies (Special Provisions) Act, 1985 or even the winding up provisions in the Companies Act.

A recent study, conducted by three researchers — Surbhi Bhatia, Manish Singh and Bhargavi Zaveri — provides a fresh perspective to this debate on whether the IBC is losing its effectiveness. According to the study, a resolution of a case within 180 days, the first deadline mandated in the IBC, is less than 5 per cent. The probability of resolution of cases increases significantly within 270 days, the second deadline under the IBC, upto between 10 and 30 per cent. And within 360 days of a case being admitted, the chances of resolution are even better at 30 to 70 per cent.

These findings are certainly reassuring, compared to what the earlier studies had indicated. A 2018 study, led by Josh Felman and others had concluded that the 12 large cases, referred to the IBC by the Reserve Bank of India in 2017, could take more than 500 days and smaller cases could take up to 350 days for resolution. At around the same time, Ajay Shah and Susan Thomas came out with a study that suggested there was an 80 per cent chance that a case might not be resolved even after 270 days.

Clearly, the study conducted by Bhatia, Singh and Zaveri has presented a more optimistic picture as far as the IBC's effectiveness is concerned. Notably, this is also borne out by the data that the Insolvency and Bankruptcy Board of India (IBBI) put out early this year.

According to the IBBI data as on December 31, 2018, as many as 1,484 cases have been admitted so far. Of these, 142 cases or 10 per cent have been closed on appeal or review. Sixty-three cases have been withdrawn, indicating how the borrowers' behaviour has become more compliant once the cases are taken up under the IBC process.

Seventy-nine or about 5 per cent cases have been closed after resolution. And 302 cases or about 20 per cent, have been closed after liquidation. Almost three-fourths of the cases that have been closed after liquidation are about companies that were either defunct or were languishing at the Board for Industrial and Financial Reconstruction, set up under the Sick Industrial Companies (Special Provisions) Act. This is also a reflection of how the earlier law had failed to bring about quick resolution and the IBC has succeeded in securing a relatively earlier closure for them.

About 61 per cent of these cases — 898 in all — are under different stages of the corporate insolvency resolution process (CIRP). The IBBI data shows that about 30 per cent of them have been registered with the IBC process for more than 270 days. Another 18 per cent of the cases under CIRP have been registered for a period between 180 and 270 days. In other words, almost 48 per cent of the cases under different stages of CIRP have already crossed the second deadline for resolution under the law. This is what should cause concern.

Yet, there are several positive signals emerging from these numbers. One, the IBC process is certain to help India improve its ranking under insolvency resolution process in the 2019 edition of the World Bank's *Ease of Doing Business* report. In 2018, the World Bank report had mentioned that resolution of insolvency in India usually takes about 4.3 years. The data now shows there is an improvement and whatever it is worth, India's ranking in the World Bank Ease of Doing Business index should improve a few notches in 2019.

Two, the IBC process is helping create greater certainty in the minds of investors as also lenders on the timeline for exiting businesses when they become unviable and have to be shut down. This is good news for a country where capital is scarce and needs to be freed up from unviable projects as early as possible. And three, the IBC process has already seen a positive change in the behaviour of borrowers, leading to greater compliance.

It is reasonable, therefore, to suggest that the functioning of IBC so far has not got the kind of credit that is due to it. Not only has it outdone similar laws of earlier years, it has the potential of changing the behaviour of investors, lenders and borrowers to create a more healthy ecosystem for India Inc.

$5 bn swap smartest move of RBI gov

The new instrument could be a permanent fixture in the RBI's liquid management toolkit, the level of the rupee determining the frequency of use

BANKER'S TRUST

TAMAL BANDYOPADHYAY

India's banking regulator's decision to hold a $5 billion three-year US$/Indian rupee buy/sell swap auction (on March 26) is driving forward premia down, paring the hedging cost of corporations for their overseas borrowings.

This is one of the many outcomes of the Reserve Bank of India's (RBI) latest liquidity infusion move through a unique instrument. Indeed, in the past too, the RBI had infused rupee liquidity using this route but that had been done (last time in 2013) in difficult times, when the local currency was under attack.

This diversifies the liquidity management toolkit of the RBI. A cut in the cash reserve ratio (CRR) or the portion of deposits commercial banks keep with the central bank (on which they don't earn any interest) is the conventional way of infusing liquidity on a durable basis. The RBI's preferred way, in recent times, has been the so-called open market operations (OMOs): Buying bonds from the banks and releasing money.

Through this auction, the RBI will buy dollars from banks and release equivalent amount of money — close to ₹35,000 crore into the system for three years after which the banks will buy back the dollars from the central bank. To hedge against the likely depreciation of the rupee during this period, the banks will pay the swap cost to be decided at the auction. Even if the local currency depreciates more, the banks' liability is fixed and the RBI too runs no exchange risks as it holds enough dollar assets and won't need to buy dollar from the market three years later.

In 2013, when the rupee was fast depreciating against the dollar and India was staring at its worst current account deficit, the banking system mobilised $26 billion through foreign currency non-resident bank account (FCNR-B) deposits to shore up India's foreign exchange reserves. The RBI encouraged the banks to aggressively mop up such deposits (and get rupee in exchange of that) by offering a hefty discount to the prevailing $/Re swap rate in the market at a special window, kept opened between September 10, 2013 and November 30, 2013. These deposits matured in November 2016.

We need to wait till March 26 to know the cut-off swap rate at the auction. Since the local currency is doing fine and there is no urgency to pile up foreign exchange reserves, the RBI is unlikely to offer any sops to the banks this time. In 2013, it had subsidised the swap cost as the context was different: We needed foreign exchange and the rupee liquidity was an offshoot of that.

During the current fiscal year, the RBI has so far infused close to ₹3 trillion in the system through the OMO route. Why has it chosen the new tool and what are the benefits?

The liquidity is being kept lubricated through regular bond buying by the RBI but the liquidity deficit will intensify as typically in the run-up to a general election more and more currency seeps into circulation, leaving the system. Besides, corporations are paying their advance tax for the March quarter now. The currency in circulation was ₹19.87 trillion in January, far more than the ₹16.6 trillion a year ago. The credit deposit ratio in the banking system has been hovering around 78 per cent for months. This is high but even higher is the incremental credit deposit ratio — more than 100 per cent for quite some time.

For every ₹100 deposit, banks are to invest ₹19.5 in government bonds and keep another ₹4 with the RBI as CRR. But since deposit growth is tardy, they are using their entire fresh deposit and capital to lend. If this continues, the cost of money cannot come down despite a rate cut by the RBI.

The timing of this experiment is apt as foreign currency has started flowing in through the newly opened voluntary retention route or VRR. The RBI in October 2018 announced this channel to facilitate foreign portfolio investment in the Indian debt market but the scheme, which is pretty liberal, was finalised in early March and it is attracting good flow. Besides, the National Company Law Apellate Tribunal giving the go-ahead to ArcelorMittal's ₹42,000 crore bid for the debt-laden Essar Steel will ensure another $6 billion flow. This will push up RBI's foreign exchange reserves, currently at $402 billion.

While the new tool will infuse rupee liquidity in the system, it will also bring down the hedging cost for Indian corporations raising money overseas. In other words, apart from generating liquidity, the new tool will also open up alternate source of funding for capital-starved Indian corporations, particularly those that want to make investments in new projects but not getting money from the local banking system.

This may, however, stiffen the yield curve of government bonds at the longer end even as there should be a liquidity-driven rally at the shorter end. The RBI's continuous bond buying through OMOs has been keeping the long bond yield low. When the RBI sells dollars to stem the volatility in the foreign exchange market, it sucks out liquidity from the system (for every dollar it sells, an equivalent amount of rupee goes out of the system). And, when it buys bonds through OMOs to infuse liquidity, the yield drops. Why? Purely, a demand-supply game. When the demand for the bonds comes from the RBI, prices increase and yields drop. The OMOs help banks as they are able to get rid of illiquid securities without paying the price for it and make money.

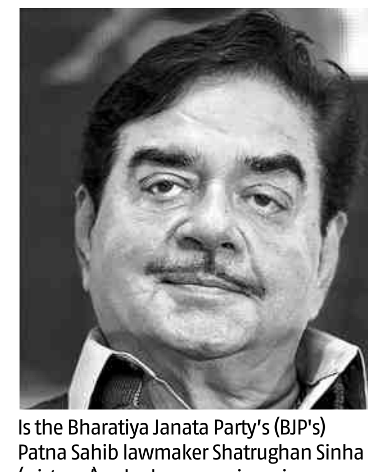
Incidentally, banks' holding of excess government bonds has come down and many of them may not have enough securities to participate in OMOs. Indeed, they hold close to 26 per cent of liabilities in bonds against regulatory norm of 19.5 per cent but they need a large part of the cushion to conform to the so-called liquidity coverage ratio, leaving little to sell to the RBI.

Given a choice, I think, the new instrument will be a permanent fixture in the RBI's liquid management toolkit, the level of the rupee determining the frequency of use. The Indian currency is now trading at a level (closed at 69.09 to a dollar on Friday), far stronger than its historic low of 74.48 seen in October 2018. On the metric of real effective exchange rate, it is over-valued, making it an ideal situation for such a cool experiment. I'd say this is the smartest move of new RBI governor Shaktikanta Das since he has taken over.

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

CHINESE WHISPERS

Gunning for attention



Is the Bharatiya Janata Party's (BJP's) Patna Sahib lawmaker Shatrughan Sinha (*pictured*), who has an acrimonious equation with the leadership of his party, finally ready to quit? In a series of sharply-worded posts, he took on the government over what he alleged were "unfulfilled poll promises". In one of the posts, he said, "You may be having many admirers but I won't be one of them." In another, he sent out a warning that he might not stick around for long. In January, too, he had said he was ready to quit the BJP "at once". He, however, had one condition — the party "high command" must ask for his resignation.

Hot seat

All of a sudden, the Pauri Garhwal (Uttarakhand) Lok Sabha seat is the cynosure of all eyes. Manish Khanduri, who is a son of former Uttarakhand chief minister B C Khanduri (*pictured*) and has joined the Congress over the weekend, is expected to be fielded from the seat, which his father, a retired major general, represents. There are at least three hopefuls from the Bharatiya Janata Party (BJP) side. National Security Advisor Ajit Doval's son Shaurya has been campaigning in the district for over a year now. Col (retd) Ajay Kothiyal is also seeking the BJP ticket. Rear admiral (retd) Om Prakash Singh Rana is a potential candidate listed by the BJP for contesting from the constituency. Khanduri senior has refused to contest the seat this time, citing poor health.

Room for appeal

During a recent hearing in the National Company Law Appellate Tribunal (NCLAT), Chairperson Justice S J Mukhopadhyay expressed his anguish at the state of infrastructure provided to him. He went on to ask why, at the age of 70, he should work so hard when the government was refusing to provide adequate support. The NCLAT functions from a small office building in the CGO Complex. Despite many requests from lawyers and even directions from the Delhi High Court, there has been little progress on upgrading the NCLAT infrastructure.

INSIGHT

GST on real estate: Transition is key

Tomorrow's GST Council meeting, which is expected to finalise the transition provisions, will be keenly watched

M S MANI

Both consumers and builders were delighted with the reduction in the GST rates announced by the GST Council in a recent meeting. The reductions were quite impressive as the erstwhile rate of 12 per cent was brought down to 5 per cent and more importantly, the reduced rate of 8 per cent applicable to affordable homes was slashed to 1 per cent. There was expectedly a condition that the reduced rates would disentitle builders from taking input tax credit (ITC) on their purchases.

The condition that ITC cannot be availed of by builders has led to some predicting an increase in real estate prices, especially in the case of affordable homes, instead of the expected reduction. At this stage, it is necessary to understand that, even earlier, in case of restaurants, the rate reduction was accompanied by a condition that no ITC was permitted. However, in case of restaurants, a large portion of the inputs such as grains, vegetables, fruits and milk do not attract any GST and hence the loss of ITC is only on some expense items such as rent and franchise fees. In the real estate sector, a significant portion of the inputs such as steel, tiles, sanitary fittings etc. attract GST at 18 per cent and cement attracts 28 per cent. The denial of ITC would certainly have an impact on builders. We also need to understand that a large part of the project cost would be attributable to the cost of land (which does not attract GST), which in some large cities could be as high as 50 per cent of the total cost. Hence the impact of the ITC denial would vary across projects with estimates putting the quantum of ITC anywhere between 3 per cent and 8 per cent. There are reports that some states would like to have an option of continuing with the earlier higher rates with input tax credit.

There is also a need to consider the manner in which builders and home buyers would be taxed after April 1, when the new rates come into force. To finalise the transition provisions, a GST Council Meeting is scheduled for Tuesday, March 19. Home buyers, who have booked an apartment and have made part of the payment, would expect that the builders charge the lower rates of GST on invoices raised and payments made after April 1. Builders will have to grapple with challenges such as dealing with ITC on purchases of inputs made before that date where a large part of the inputs have already been used in the projects. For projects where effective construction is completed by March 31 but occupancy certificate (OC) is obtained after that date, there could be an ITC loss on instalments collected after April 1. A formulae to avail of ITC in case of under-construction projects could figure in the discussions of the GST Council tomorrow.

There has been a renewed focus on affordable homes, this time from a GST perspective, clearly in line with the government's plans of housing for all by 2023. The carpet area limits have been increased to 60 sq mt in case of metros and 90 sq mt for others, with a common value cap of ₹45 lakh for all affordable housing projects. In these cases, while a rate of 1 per cent would be attractive for the buyer, the quantum of denial of ITC would determine whether there has been a significant dent to the builder and whether the builder would be compelled to marginally increase the price of the apartment, if permitted, to overcome the ITC loss.

It is necessary for builders to pass the benefits of the rate reductions to the home buyers in terms of the mandate of Section 171 of the CGST Act, 2017, and his failure to do so would bring him in the crosshairs of the National Anti Profiteering Authority (NAA). In earlier cases, the NAA has consistently refused to permit netting off expenditure increases against rate reductions and has reiterated the intention that the benefit of a tax rate reduction has to be passed on to the consumer, even if other costs have increased. These principles would now be tested if builders do not bring down prices commensurate with the rate reduction made, on the plea that ITC denial does not allow them to pass on the entire benefit.

The real estate sector has faced significant headwinds in the past few years in the form of RERA, demonetisation, working capital pressures etc. in addition to GST. While GST is one element in the overall picture, it is an important tool to revive an employment intensive sector like real estate and hence the Tuesday meeting of the GST Council, which is expected to finalise the transition provisions, will be keenly watched.

The author is partner, Deloitte India Views expressed are personal

LETTERS

Interpreting Modi

This refers to "Modi and the Liberals" by TCA Srinivasa Raghavan (March 16). Both, the Congress and the country, are paying the price for not cultivating a proactive Opposition in politics and in the Parliamentary system of governance we adopted, post-independence. The piece suggests some action points that can be considered by Narendra Modi (*pictured*) if he is serious about retaining the Bharatiya Janata Party (BJP)-led National Democratic Alliance in power for another term and beyond.

The Congress would have done much better in 2019 if the party had come out of the illusion that British had handed over India to one family. The party seems to believe that the absence of family control in governance is just an aberration, off and on, and India can ill-afford to displease the Nehru hierarchy in the long-term. This belief is preventing the party from accepting new ideas or professionalising leadership at different levels.

To prove that an alternative to the Nehru-Gandhi legacy is possible, Modi and the BJP will have to wake up to the need for upholding secularism and prove that Hindutva was just a stepping stone and that they are not averse to building a consensus about upholding the spirit of the Constitution.

What Modi does and speaks during the few weeks left before the elections will be crucial in deciding India's fortunes in the next decade, irrespective of who wins or loses in the election.

M G Warrier Mumbai

A bridge too far

That was the title of the movie and book on Operation Market Garden — the largest paratroopers cum ground force operation in military history carried out in 1944. The Allies needed to capture three bridges but they failed. But in India, particularly in Mumbai, every suburban train commuter needs to "capture" bridges at least four times in his daily sojourn. The first issue is that when an accident takes place, all authorities compete to point out who is not responsible. If the bridge belongs to and is the responsibility of the Indian Railways, then will the municipal authorities also cede the mandatory 25 metres space in the periphery as in the case of rail lines? How about a board on each bridge that this bridge is under this authority and if there are borders within the bridge, that is, at which point the responsibility of one authority ends and the other takes over, that too should be demarcated on the floor of the bridge.

The same can be applied for flyovers, sky walks etc. How about a special "bridge insurance" with only those who hold suburban train passes eligible for a claim in case of a mishap?

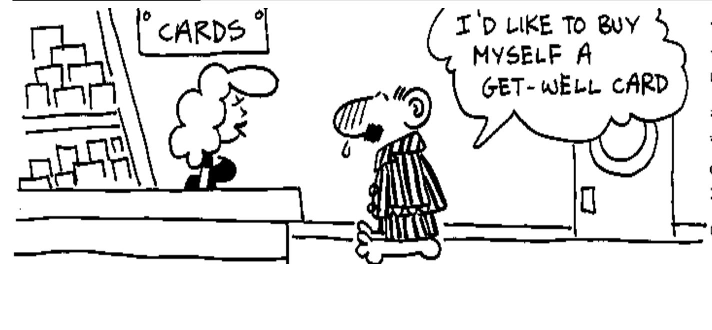
Again, the unnecessary load contribution by hawkers and other unauthorised stuff that one always finds on these bridges should be cleared at once.

To evenly spread the load, there must be a central barrier and pedestrians must keep to the left in both directions. Can the bridges take the load that has increased by more than three times since they were built? These are questions that need to be answered.

T R Ramaswami 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
All letters must have a postal address and telephone number

HAMBONE



Business Standard
Volume XXIII Number 153
MUMBAI | MONDAY, 18 MARCH 2019

Anaemic exports growth

Trade deficit hits a new low, but that's small consolation

According to the trade data released by the Union ministry of commerce on Friday, India's trade deficit is at the lowest it has been for more than a year. The deficit — the difference between how much India exports and how much it imports — reached $9.6 billion in February 2019, as compared to the $14.7 billion deficit registered in January 2019. Yet, this cannot be seen as a sign that stability has returned to the external account. In fact, the data reveals that India's structural weaknesses continue, and thus macroeconomic stability cannot be taken for granted. In particular, weak exports growth shows that India will continue to struggle to pay for imports if the demand for those recovers.

Exports rose just 2.4 per cent year on year in February 2019, lower than the 3.7 per cent increase registered in January. Crucial sectors such as engineering and gems & jewellery saw low or negative growth. Gems & jewellery exports, for example, contracted by 2 per cent. It is clear that any hope that was raised earlier this financial year of a rebound in exports was illusory. Indeed, the withdrawal of the Generalised System of Preferences trading programme from Indian exports by the United States administration will only make it tougher for certain export sectors to recover. This is particularly true of Indian engineering exports, which will have to deal with tighter competition from zero-tariff countries. There has been some improvement on the ground in terms of permission and ease of doing business over the past few years, but not enough to ensure competitiveness. It is not realistic, therefore, to expect a sharp upturn in the short or medium run for Indian exports in these sectors. The Federation of Indian Exporters has blamed global conditions for this poor performance. But this claim does not stand up to scrutiny. According to Deutsche Bank, for example, the weekly Harpex Shipping Index tells the opposite story — that global trade began to improve in January. Though the shipping index is not necessarily an index of either world trade or the global economy, it is an indicator.

The reason that the trade deficit has narrowed is thus not a robust performance from exports but a fall in imports. This is driven partly by a decrease in the oil import bill. As has been seen in the past, such a decrease can hardly be relied upon to keep India's external account stable — in fact, quite the opposite. Gold imports also fell, puzzling many observers. But non-oil, non-gold imports contracted for yet another month — falling 3.7 per cent in February, following on from a 0.8 per cent fall in January. This is a disquieting trend, as it suggests sluggish industrial demand within India. It is also hard to reconcile with the overall data on economic growth. If growth in Indian gross domestic product (GDP) is at an all-time high, it is hard to see why import demand would be falling. It is also difficult to see how exports growth can be so anaemic if the Indian economy is seeing record economic growth. This underlines the continuing concerns about data that are being raised by economists at this time.

Brexit in limbo

Ms May has not served UK's best interests

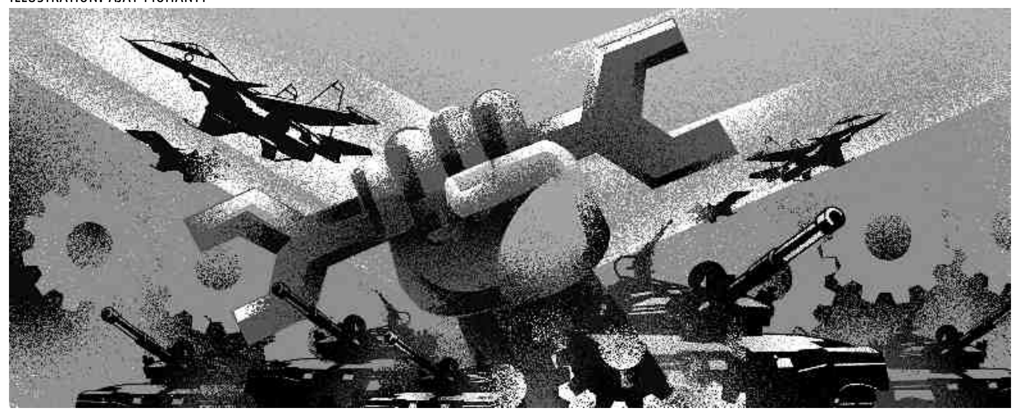
As the UK gets ready for yet another vote on Brexit on March 19, the only certainty that can be predicted is more uncertainty. With a mandate from Parliament to extend the Brexit deadline from March 29, Prime Minister Theresa May is bracing herself to bring her third Brexit deal to vote. This vote is required ahead of the European Union summit of March 21-22, where she will appeal for an extension of Article 50, the withdrawal notification. The outcomes of both events on the Brexit timetable are, however, open questions. It is hard to see why she should win another vote on the same deal when many Conservative MPs defied the party whip to hand her one of the largest defeats in parliamentary history just last week.

Indeed, nothing seems to have materially changed. The "Irish backstop", which keeps the UK in the EU until a new agreement, remains the point of fierce contention. The backstop has created turmoil because it potentially commits the UK to a customs union with the EU without any say in rule-making — that is, if the UK and the EU do not reach an agreement by December 2020, when the pre-negotiated transition period ends. This defeats the purpose of Brexit in the first place. Ms May insisted that the new deal she negotiated with the EU — after her first deal was defeated in January — offered assurances that the backstop would not be imposed indefinitely, only to be contradicted by the Attorney General.

The short point is that Ms May has not served the UK's best interests, as she claims. The country is in a bind, more so now that MPs have voted strongly against a second referendum. First, she set an extremely challenging deadline for Brexit — just two years. Then she inexplicably called elections, which whittled the Conservative majority so drastically that she is forced to depend on the Irish Democratic Unionist Party (DUP) to stay in power, which has led to the complication of the backstop. Third, she has refused to accommodate cross-party talks with the Opposition, which may have won her more support.

Much now hinges on the upcoming EU summit. By one interpretation, the extension can last only till May 23; any delay beyond that would require the UK to participate in the elections for the European Parliament (EP), which begin on that day. By another, the deadline could extend to July 2, when the new EP members take their seats. Ms May appears to be banking on the latter date, assuming it will give her more time to sell her unpopular deal. On the whole, the issue is now so wide open that no one can say with any assurance where Brexit is headed. Meanwhile, the Centre for European Reform has shown that the British economy is 2.5 per cent smaller than it would have been had the Remainers won the Brexit vote. The chancellor of the exchequer has revealed that the country is scheduled to spend a stupendous £4.2 billion on Brexit negotiations. All economic modelling has shown that the UK will be worse off outside the EU. It's literally Mayday for Europe's second-largest economy.

ILLUSTRATION: AJAY MOHANTY



Self-reliance in defence

The design, development and production of defence equipment must be indigenised for strategic independence

Over the past few weeks we have heard a lot about the Rafale deal in the political playground and the media. The focus of the arguments is mainly around the cost of the present deal as compared to the earlier one which was under negotiation and about the role of the Prime Minister's Office (PMO) in the negotiating process. This particular football will continue to be kicked around during the election campaign and after. This is par for the course for a major international arms acquisition deal.

The real problem is being bypassed in this debate. It is our heavy dependence on imported arms supplies. According to the SIPRI (Stockholm International Peace Research Institute) database, the volume of international arms transfers to India was around $3 billion in 2017.[1] The other major claimants to global or regional power status[2] do not depend on arms imports except from close allies, the arms transfer to all of them being just $4 billion in 2017. In fact, many of them are major exporters of sophisticated arms.

NITIN DESAI

No country that depends heavily on others for critical weapons systems can hope to have strategic independence. From a long-term perspective, the arguments voiced about the Rafale deal do not really address what should be our core concern — our continuing dependence on other powers not just for sophisticated systems like fighter planes but even for basic things like rifles. Our defence acquisition process has failed to stimulate long-term investments in armaments research, precision engineering, new materials, sophisticated electronics and other such areas that are the foundation for the manufacture of sophisticated weapons.

A defence equipment industry has to rest on a diverse and substantial manufacturing capacity and research competence in the economy as a whole if it is to keep up with its competitors. That is why Pandit Nehru's note on defence policy written more than 70 years ago in 1946 states: *"No country which is not industrialized can carry on war for long, however good the army might be. No country which has not got its scientific research in all its forms and of the highest standing, can compete in industry or in war with another."* This strategic perception, rather than the Mahalanobis model, lay behind the drive to promote the rapid development of basic industries and the strong commitment and support given for the establishment of defence-related R&D capacities like the Defence Research and Development Organisation (DRDO) and the Atomic Energy Commission.

How well have we done on these twin objectives of building manufacturing capacity and research competence?

At the macro level, the share of manufacturing in GDP did rise in the first phase of planning from around 11 per cent to nearly 16 per cent by the mid-seventies. But since then this proportion has hovered around the 17 per cent mark. This aggregate number of course does not capture the definite change in the degree of sophistication in the manufacturing sector. Moreover, we must recognise that developments outside the manufacturing sector, for instance, in information technology, also have substantial strategic value. Yet if one compares India to China, one cannot escape the conclusion that in most sophisticated products we are still dependent on imports for production technologies, specialised materials and precision-engineered components.

With regard to science and technology (S&T), the picture is not much better. India accounts for about 4 per cent of global R&D spending, according to the authoritative Batelle assessment. For comparison, China accounts for 21 per cent, more or less equal to the share of Europe and only a little short of the share of the USA. Our R&D spending as a proportion of GDP is just 0.7 per cent, according to official statistics.

Clearly we have a long way to go in meeting the challenge of creating world-class manufacturing and S&T capacity. A determined effort to develop a sophisticated defence equipment industry by providing long-term assurance of demand can play a crucial role not just for strategic independence but also for upgrading the civilian part of the economy because of the potential spin-offs. Much of the United States' strength in civilian technology areas rests on heavy investments in defence research and production, both by the government and the private sector. The internet and information technology are prime examples of this spin-off.

As far back as 2004-05, the Kelkar Committee report on strengthening self-reliance in defence preparedness laid out a glide path for moving from import dependence to building genuinely Indian weaponry. A key part of this was the identification of champion companies which could undertake long-term research, development and production in the private and public sectors.[3]

Unfortunately, this has not happened. On the one hand, public sector units like Hindustan Aeronautics Ltd (HAL), which have built substantial technical competence, are being bypassed for perceived shortcomings in performance, particularly with regard to timely delivery. On the other hand, the effort to build competence in the private sector has not gone much beyond contract manufacturing. Long-term commitments of assured demand to promote research and competence building in private sector companies are still unknown, perhaps because of a fear about crony capitalism accusations. The DRDO has been funded and accounts for about one-third of public spending on S&T. It has some significant achievements to its credit, but there is still a big trust deficit between the user services and the DRDO. Yet another factor is the pressure to quickly match the capabilities of potential foes by importing rather than waiting for an indigenous option. As for "private incentives" from suppliers, the less said the better.

These fault lines need to be erased. We must now aim at bringing together the user services, the researchers and the chosen producing companies together in national missions for specific defence systems. We must short-circuit the political jousting by creating a multi-party security council that will be asked to endorse these national missions. We must be ready to live with some short-term risks for stronger and more reliable long-term security. Only then will we have the strategic independence that we need to protect our national interests.

[1] SIPRI values transfers at a standardised price, which for the Rafale, for instance, is $55 million per aircraft, way below what India will actually pay

[2] This includes the present and potential aspirants, other than India, for permanent membership of the UN Security Council: The USA, Russia, China, the UK, France, Germany, Italy, Japan, Brazil and South Africa

[3] For more on this, see Ajai Shukla "Why Defence Indigenisation Fails", Business Standard, July 30, 2018

nitin-desai@hotmail.com

Repo-linked deposit rates: A tiny half-step

On Friday, March 8, State Bank of India (SBI) announced that starting May 1, savings bank account deposits and short-term loans (overdraft and cash credit) above ₹1 lakh would be linked to the Reserve Bank of India's (RBI's) repo rate from. (Repo is the rate at which the central bank lends money to banks when they face shortage of funds.)

Every single commentator I read has hailed the move as a logical next step, after the RBI asked the banks in December last year to link all new floating rate retail loans like home loans with an external benchmark from April 1, 2019. Any careful observer will immediately notice that what the central bank wanted and what SBI has done are far apart.

IRRATIONAL CHOICE

DEBASHIS BASU

SBI has linked *deposit* rates to repo rates (thereby making them floating, from fixed). But it has not announced the linking of *lending* rates of longer-term loans for businesses and retail customers of home loans, personal loans, auto loans, etc. to make these true floating rates. For borrowers affected by the opaque and discriminatory practices of banks, the loot will continue. Remember that under Urjit Patel as governor, the RBI had announced that banks would have to link lending rates to an external benchmark, but, under the new governor, it is showing no hurry to take this forward. In fact, it almost seems certain that April 1 will come and go and banks will be let off again. That would be in line with RBI's repeated failure to ensure a proper transmission of interest rates where a reduction in the interest rate by the central bank would ensure lower rates across the system and vice versa. Will SBI's move help the RBI's objective of improving transmission? Consider this:

1. Banks have been claiming that since the bulk of the deposits is fixed, they do not have the flexibility for transmission. How much of bank deposits are in savings accounts? For SBI, savings account deposits make up 38 per cent of the total. Of this 20 per cent are below ₹1 lakh. This means that only 80 per cent of 38 per cent, that is 30 per cent of deposits, will be floating. So, 70 per cent of deposits will remain fixed, which would continue to hamper the ability of banks to implement a true floating rate regime.

2. What would be the impact on the bank's marginal cost of lending rate (MCLR)? A 25 bps reduction in the interest rate on these deposits could lead to a reduction of only 7 bps in the bank's MCLR with this move. It is better than before but only a very tiny step.

3. In any case, SBI taking a tiny half-step forward won't mean much for the system as a whole, unless the rest of the banks follow SBI. According to media reports, most other banks are not likely to do so.

4. According to one interpretation, after the savings account is repo-linked, part of such deposits will get converted into fixed deposits. If so, even less of the deposits would be repo-linked, reducing the transmission even further.

Deposits: The false bogey

There are two critical factors being missed in this debate. One, while banks are making a song and dance about the fact that their liability side is not floating, the real issue is the spread. In the debate on transmission, there is surprisingly no discussion on what other factors go into deciding the spread, and thereby the lending rates of banks. For the MCLR, the RBI methodology includes three more factors other than the cost of deposits/funds: Negative cost of carry on the cash credit ratio and statutory liquidity ratio; unallocable overheads which left enough scope for banks to show a higher figure by not being clearly defined; and average return on net worth, which is another figure that banks can fudge. Even experts blame the inflexible cost of deposits (funds) as the *only* hindrance to transmission. There is no scrutiny of the other three factors that determine the MCLR. The RBI has also played along with this farce.

Two, the biggest impediment to public sector banks (PSBs) not being able make their lending rates truly float is irresponsible, indiscriminate and corrupt lending that has created a mountain of bad loans. This has made them bankrupt, requiring public money to be pumped in to revive them, over and over again. Unaccountable bankers have hampered the PSBs' ability to lend and this has kept lending rates high, while they blame a distant factor such as inflexible deposit rates for lack of transmission.

The transmission of interest rates has failed miserably for 20 years, partly because of poorly designed policies and partly due to the benign negligence of the RBI. Banks are focused on their bottom line and not on transmission. Transmission reduces their profits and, hence, is not a concern to them. SBI could have made its deposit rates floating anytime since 2011 when the RBI policy allowed it to do so. But it didn't. It has acted now, under pressure, as a nod in the direction mandated by the RBI. If transmission has to succeed, we need a clear set of guidelines that do not allow banks to fudge internal calculations to cheat borrowers, and continue with the status quo.

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

Journalism's advocate

BOOK REVIEW

PREET BHARARA

For many Americans, the greatest reason to cheer during the sleepy, low-scoring game that was Super Bowl LIII was not the Patriots' victory. In certain circles, it was the highly anticipated, multimillion-dollar commercial produced by the *Washington Post*, featuring the voice of Tom Hanks and heroic footage of journalists from various outlets that proclaimed, over a soaring score, these simple truths: "Knowing empowers us, knowing helps us decide, knowing keeps us free."

It was a good ad, inspiring even. Who doesn't love Tom Hanks? But you could find *The Washington Post* commercial uplifting and also saddening, insofar as it was deemed necessary.

It was an astonishing thing to witness — an iconic news organisation feeling the need to hawk not the quality of its writing and reporting, but the most fundamental virtues of its entire industry's mission. Like truth. And knowledge. Values thought to be long settled. Merely having your business model enshrined in the First Amendment to the Constitution is no longer sufficient; now you need airtime during the Big Game to respond to crude and corrosive attacks on the free press by a president and his supporters with their incessant charges of "fake news!"

Fake news. It is a juvenile epithet, but it has power because it is both thoughtless and memorable. It is also a debate stopper. When uttered with a contemptuous smirk, it's the equivalent of "shut up!" No intelligent response can suffice, no evidence-based retort can win. "Fake news" has the charm of comedy, the ease of a sound bite and now the imprimatur of the president of the United States of America.

In his fine new book, *Truth in Our Times: Inside the Fight for Press Freedom in the Age of Alternative Facts*, the *New York Times* deputy general counsel David E McCraw thoughtfully (and entertainingly) addresses this state of affairs as he takes us behind the scenes of the venerable (or failing, depending on your perspective) *New York Times*. A self-professed "raving moderate," McCraw is in prime position to provide this backstage view as he draws equally on his experience as a writer and a lawyer. He excels at both, explaining legal issues in lay terms and unspooling the stories that propel the book.

But McCraw's job was far more interesting than assisting in occasional ad-making. He faced the challenge of vetting articles for libel, obtaining blockbuster documents through the Freedom of Information Act, greenlighting the publishing of purloined secret information and standing up to intimidation from unhappy subjects of stories, one of whom is the current president.

There is plenty about Donald Trump here, whose danger to the free press McCraw concedes he was slow to acknowledge. His professional experience with Trump went back many years, and he adroitly tells the story of how Trump, in 2004, threatened to sue over the one slight he truly could not bear — that he was less wealthy or successful than he claimed. The Times had reported that his boast on "The Apprentice" that he was the "largest real estate developer in New York" was plainly false, by every objective measure. This was an intolerable slight, and it drew the future president's wrath. But Trump's outlandish claim was indefensible, and the matter was dropped.

Then there was the occasion when a portion of Trump's 1995 tax returns showed up one day in a reporter's mailbox during the heat of the 2016 campaign. McCraw describes the warring that ensued. Belligerent Trump lawyers threatened legal action, as usual. In the end, as in every other instance of high-decibel Trumpian legal threats, the dog barked but never bit.

McCraw also takes time to meditate on journalistic practices and ethics. He is candid and cleareyed about the lean of his paper's readers and its opinion writers. He says that by the "time of Trump's election there was no doubt about the politics of our core readership: It skewed left, and, in any measure of its opposition to Trump, it went off the charts." He concedes, moreover, that *The Times*'s "Op-Ed columns and contributors are overwhelmingly anti-Trump, every day." But he is insistent about the overall political objectivity of the news people, the beat reporters. He argues that the everyday news folk, at The Times and elsewhere, are not generally partisan. He doesn't claim that they are perfectly detached, disinterested, nonideological chroniclers. He acknowledges a certain lean on their part too. "Many journalists are biased," he concedes, but "just not in the way that most people think about it."

By McCraw's reckoning, reporters tend to champion the underdog, and it is this worldview that skews their coverage. "The easy rap," he writes, "is that most reporters lean liberal (true), and that dictates how they cover a conservative like Trump (false). ... They believe, all other things being equal, that the little guy is getting screwed. ... The reportorial default is to think that most regulations are good, the rich and connected don't need more money or more power." He insists, therefore, that any bias "is not a left or right thing."

McCraw is rightly proud of his role in defending *The Times* in so many controversies. But there is also a whiff of helplessness in his telling about the degradation of truth and of people's trust in the press, neither of which is really a matter of law or legal policy. The law, it turns out, is in good shape.

Legal freedom, as an attorney might say, is necessary but not sufficient. Just as important, McCraw explains, is public trust: "It doesn't really matter how much freedom the press has in a society if the press is not believed. A distrusted press is little different from a shackled press." This is the crisis, well identified. One need not literally shutter press outlets in the manner of Recep Tayyip Erdogan or Xi Jinping or Vladimir Putin to render the press irrelevant and impotent.

But occasional and understandable bouts of pessimism aside, *Truth in Our Times* is not dire. It is spirited and hopeful and even, at times, lighthearted. It is, in a way, a love letter to the First Amendment. McCraw captures the mood best in one early sentence: "It was a hell of a time to be a lawyer for *The New York Times*." It sure was.

TRUTH IN OUR TIMES
Inside the Fight for Press Freedom in the Age of Alternative Facts
David E McCraw
All Points Books; $28.99; 304 pages