Opinion

MONDAY, JULY 1, 2019

INDO-JAPAN RELATIONS

Prime Minister of India, Narendra Modi

Today, there is no such part of India where Japan's projects or investments have not left its mark. Similarly, talent and manpower of India are contributing to strengthen Japan

Not just politicians, courts also to blame for quotas

After *Indra Sawhney* put a cap on reservations, SC did nothing to ensure it was met, even relaxed norms in various judgments

WITH MAHARASHTRA'S RESERVATION quota rising to 65% after the Bombay High Court (BHC) upheld reservations for Marathas—possibly even 75%, once you add prime minister Narendra Modi's 10% quota for economically weak sections (EWS)—it is easy to blame politicians for striking yet another blow against merit. If 65-75% of college admissions and government jobs—and, within this, promotions—are to be determined by quotas, apart from how this reduces the opportunity for general category students, how is India to compete in an artificial intelligence/machine-learning world where merit and knowledge are critical? But, why blame just politicians who, by their very nature, only look for immediate electoral gains. Certainly, the government has amended the Constitution to negate various apex court judgements on quotas and has tried to hide certain laws on reservation from the Supreme Court's (SC) scrutiny by classifying them under the Ninth Schedule. But, in *IR Coelho*, in 2007, SC had ruled the Ninth Schedule was not sacrosanct if it violated Constitutional provisions on fundamental rights.

While the Maharashtra State Backward Class Commission said Marathas were socio-economically backward, a decade ago it had said they were both economically and politically—half the state's MLAs and CMs have been Marathas—a forward caste, something even the Mandal Commission had said. It is surely odd that BHC didn't deal with this. And since a nine-judge SC bench in *Indra Sawhney* had capped reservations at 50%, it is surprising SC didn't object to the 10% EWS quota earlier this year; ditto for BHC in the Maratha case. While BHC said the *Indra Sawhney* cap could be violated in exceptional circumstances, where there was "quantifiable and contemporaneous data reflecting backwardness" and "inadequacy of representation", it just needed to study the facts to know Marathas aren't backward.

These aren't stray instances either. In 1994, in *Ajay Kumar Singh*, SC ruled on reservations at higher levels of education, something which Indra Sawhney said was not to be allowed. So, SC said, "(In *Indra Sawhney*), the Court was speaking of posts in research and development organisations, in specialities and super-specialities in medicines, engineering and other such courses. The Court was not speaking of admission to specialities and super-specialities. Moreover, M.S. or M.D. are not super-specialities"! And in 1997, in *Post-Graduate Institute of Medical Education and Research versus KL Narasimhan*, SC said, "Securing marks is not the sure proof of higher proficiency, efficiency or excellence... In that behalf, it is common knowledge that marks would be secured in diverse modes... They are awarded in internal examination on the basis of caste, creed, colour, religion, etc."!

Last month's SC ruling on Karnataka's law to allow reservation in promotions for SC/ST expanded on this contempt for marks as proof of merit. Ironically, in 2017, the same court had rejected the Karnataka law on grounds that no data had been given on inadequacy of representation of SC/ST in the service and its impact on administrative efficiency; this was mandated by the *Nagaraj* judgment of 2006. To get over the *Nagaraj* requirements, SC reinterpreted "efficiency of administration" to say it "must be defined in an inclusive sense, where diverse segments of society find representation... while interpreting Article 335, it is necessary to liberate the concept of efficiency from a one-sided approach which ignores the need for and the positive effects of the inclusion of diverse segments of society on the efficiency of administration of the Union or of a State". The judges elaborated, "a 'meritorious' candidate is not merely one who is 'talented' or 'successful' but also one whose appointment fulfils the constitutional goals of uplifting members of the SCs and STs and ensuring a diverse and representative administration". The Maratha law, and even Modi's 10% EWS quota, will probably be challenged in SC, but given SC's past rulings, getting justice isn't going to be that easy.

Sebi makes the right move

Lax rules allowed unduly risky investing by fixed-income funds

EVEN IF IT is somewhat late in the day, it is good that SEBI is tightening the rules for mutual funds (MFs), especially debt-oriented schemes; the ecosystem will be all the better for this. The fact is, MFs are dealing with the savings of small investors and, while there are no guarantees, fund managers must nonetheless treat this money with due respect. Unfortunately, in an attempt to perform better, some of them have taken undue risks, investing in companies that are clearly not credit-worthy. Through a series of measures, SEBI has made sure fund managers of liquid schemes have enough liquidity and that they are not overexposed to HFCs and the real estate sector. With the sectoral cap now at 20%, the overexposure to NBFCs, too, has been addressed. Moreover, there is a 5% prudential cap on the exposure to a particular group, much like there is for banks.

Crucially, the regulator has mandated that the schemes invest only in listed NCDs and CP. Most NCDs are, in any case, listed, but CPs are not; so, this is a good step. Given the rather primitive state of corporate governance in most companies today, one can never be too careful. The spate of downgrades over the past couple of months—including that of Piramal Capital, Sadbhav Engineering and Edelweiss Financial—is clear evidence of stress, both in the financial and non-financial sectors. Which is why, it is important to have enough of a cushion for exposure to debt securities that are credit-enhanced or backed by equities. SEBI has mandated a cover of four times, which seems sufficient.

The practice of pledging shares without making adequate disclosures has disrupted the system, and had SEBI not strengthened the disclosure requirements, companies may have continued to fool investors and lenders by resorting to unlawful methods to camouflage the extent of shares pledged. From now on, promoters need to disclose the reasons for an encumbrance if it exceeds 20% of the equity capital, which seems like a reasonable threshold.

The fact is, both ratings agencies and lenders have been very slow to red flag default risks in companies; else, even a year ago, it was evident Jet Airways is in big trouble. Now that SEBI has banned MFs from entering into standstill agreements with borrowers, fund managers will be a lot more choosy. Given they manage small investors' money, MFs have no business to be funding weak promoters. They need to be investing rather than lending, and even if the returns come down as a result, investors would not mind because their capital would be less at risk. It is a good move to have all money market instruments marked-to-market so that the schemes reflect the true net asset value and investors are not left guessing.

AccessLINGO

Govt plans to make science and technology education resources accessible in regional languages

THE MINISTRY OF electronics and information technology (MeitY) has proposed a national mission for natural language translation. The ₹450-crore proposal is based on the recommendations made by the Prime Minister's Science, Technology and Innovation Advisory Council (PM-STIAC) as part of the 100-day action plan. The purpose is to make research and teaching resources on science and technology accessible to all in two languages—one in English and the other in a native Indian language. The move is ambitious in the sense that it requires digital proficiency from the user. The translation will be done in two modes—machine and human translation—for both speech-to-speech translation and text-to-text translation. This could prove a big step in making science and technology knowledge accessible to a large citizenry.

The proposal will be implemented by central and state agencies, along involvement from start-ups. The service will not only prove beneficial for teachers and students but also for publishers and authors. It will also create translation-related jobs. MeitY's move will address the issue of low-cost education at a large scale. Nonetheless, making content translatable into all native Indian languages, along with spreading digital literacy, will perhaps be the biggest challenge—the Pradhan Mantri Gramin Digital Saksharta Abhiyan funds are estimated to be enough for making 2.39 crore in rural areas digitally literate (against a target of 6 crore). Also, not everything in advanced sciences will lend itself to translation. There could yet be many a slip betwixt the cup and lip.

FUTURE AUTOS

SIX YEARS UP TO MARCH 2025 SHOULD SURELY BE SUFFICIENT TIME FOR THE TWO-WHEELER INDUSTRY TO PLAN ITS TRANSITION TO EVs

India's big opportunity: Electric mobility

RAJIV KUMAR & ANIL SRIVASTAVA

The authors are with the NITI Aayog
Views are personal

FISCAL INCENTIVES TO promote Electric Vehicles, in the form of FAME (Faster Adoption and Manufacturing of Electric Vehicles), were launched in 2015 for a period of two years. These were later extended up to March, 2019. With its outlay of ₹450 crore during the last four years, FAME I helped about 2.63 lakh electric/hybrid vehicles, including 1.4 lakh two-wheelers (E-2W) and 1.01 lakh four-wheelers (E-4W). These are already on the road all over the country. But, this has not enabled us to accelerate the transition to electric mobility in the same way as countries like China have done by adopting a holistic approach and a time-bound plan for completing the transition.

With learnings from FAME I, the revised FAME II was announced with an outlay of ₹10,000 crore and a target to incentivise 10 lakh E-2W, 5 lakh E-3W, 55,000 E-4W and 7,000 buses (on OPEX basis) by March 2022. FAME II has been welcomed by all stakeholders, including industry and associations, for the clear roadmap that it provides for the transition to electric and connected mobility.

In the 2W & 3W segment, 21.2 million ICE 2W and 0.7 million ICE 3W were produced last year and, with a share of 9% in manufacturing, had an employment of nearly 12 million. Out of these around 15%, i.e., 3 million 2W, were exported. The CAGR of 2W & 3W vehicles is expected to be around 8-9% for the next ten years. Thus, by 2025, India will be producing nearly 28 million 2W and another 2-3 million 3W. This provides Indian companies with a unique opportunity to leverage domestic markets to achieve globally competitive scale and economies of production. Having missed the first electronic revolution in the 1980s and the semiconductor fabrication opportunity in the 1990s, India can hardly afford to miss this emerging opportunity, offered by the transition to electric mobility, that combines multiple high technology industries. We have to be right in the midst and then, hopefully, achieve pole position in this sunrise industry.

It thus becomes critical for us to adopt a time-bound roadmap for the conversion to 2W & 3W to electric vehicles. If we do not pursue this at the policy level and if companies and economies do not adapt, we risk losing out on a seat at the table in the next generation of technology and industrial development.

Both electric mobility and battery manufacturing are sunrise industries that must be encouraged if India is to become a globally competitive player in the coming decades. Otherwise, we not only stand to lose all export opportunities that are bound to open up in the coming years but also risk becoming a dumping ground for second-rate imported EVs from China and elsewhere.

Investment by industry carries inherent risk, and all our efforts should be directed toward creating a domestic market for both electric vehicles and batteries, in order to ensure OEMs and battery manufacturers have enough certainty of off-takes before they put in their investments in new manufacturing units to attain globally competitive position. India has lost out in the solar power generation and mobile/smartphone industry previously and must act quickly to secure a position in the sunrise industry of battery storage and electric mobility. Delaying this transition risks missing the opportunity at hand.

The Steering Committee of National Mission on Transformative Mobility & Battery Storage has recommended that after March 31, 2023, only E-3W (with lithium ion or other advanced battery chemistry only) shall be sold under the category of 3W and, after March 31, 2025, all new sales under the category of 2W below 150cc shall be E2W (with lithium ion or other advanced battery chemistry only).

Six years up to March 2025 should surely be sufficient time for the industry to plan its transition. Moreover, NITI Aayog has always been open and ready to consider alternative time-bound plans. However, the suggestion to do without a transition plan and adopt a so-called 'market-based or muddling through' stance should not be acceptable to anybody who is wedded to the national interest or, indeed, even to the Indian automobile industry's interests. Clearly, those companies who wish to export ICE two- and three-wheelers will have the fullest freedom to do so even after the domestic sales of these vehicles cease in the domestic market and, further, those producing 2W with engines higher than 150 cc will continue to do so.

> For globally-competitive manufacturing of advanced batteries, a challenge process to select manufacturers can be adopted

We must emphasise that NITI Aayog has had extensive consultations with all segments of the industry in the run-up to the Mobility Conference that we organised in October 2018. And, in the interest of building the necessary trust between the industry and the Government, we are, of course, open to further consultations, as long as they are aimed at reaching a time-bound transition plan towards achieving 100% electric and connected mobility.

We would, of course, have to ensure that the batteries (lithium ion or advanced chemistry) are domestically manufactured and at globally competitive prices. The scale offered by the transition to EVs will allow world-competitive capacities to come up in India. Globally-competitive manufacturing of advanced chemistry batteries could be achieved through a challenge process to select manufacturers, who could then be offered a package of facilitation and fiscal incentives to induce them to rapidly create necessary capacities in the country. This would also be used for other industries like micro-electronics, power storage etc. Using the advantage of large scale domestic demand in the EV sector, we would be able to create a dynamic and vibrant storage battery in the country.

Moreover, battery costs are expected to fall over the next few years as volume increases and economies of scale are achieved. Expert analysis anticipates that India's annual battery market size could be as large as $9 billion by 2025, the majority of which will be driven by electric vehicles (this assumes close to 100% new sales of electric two- and three-wheelers by 2025, along with modest market penetration of other segments). Private sector companies and start-ups are developing charging solutions as well as battery swapping business models to encourage the transition to electric mobility. These manufacturing capacities and business models will provide significant additional sources of economic growth.

Although around 20% of minerals in the current battery chemistry need to be sourced from outside, the R&D on material recovery and recycling from batteries would help address this scarcity. This can create a domestic reserve of minerals over time. The government, too, is exploring potential rights to international supply chains to further address this concern. In any case, battery chemistry is evolving at a rapid pace with the attempt to replace lithium as the sole principal component. And in the medium-to-long term, the transition to hydrogen will surely be initiated as is already beginning to happen in China and Japan. On all counts, therefore, including that of fresh employment generation, India simply cannot afford to miss this opportunity and cannot adopt a 'muddling through' policy stance as some stakeholder, very surprisingly, seems to advocate.

The US's zero interest rates future

The Congressional Budget Office's projections for the US federal budget during the next 30 years is a picture of steadily rising deficits

NOAH SMITH

Bloomberg

THE CONGRESSIONAL BUDGET Office has just released its projections for the US federal budget during the next 30 years. The picture is one of steadily rising deficits. Federal government borrowing now amounts to about 4.2% of gross domestic product each year. By 2049, the CBO predicts, that will more than double, to 8.7%.

Only a small portion of these deficits will be due to tax cuts; the CBO projection expects that individual income taxes rise substantially as a share of GDP. Nor will it be due to government profligacy; CBO predicts that discretionary spending will shrink substantially relative to the size of the economy.

Instead, the growth in deficits is mostly about two things. First, government health care spending is projected to grow, which is partly due to population ageing and partly because the CBO predicts that medical costs will keep going up. Second, and even more importantly, the CBO predicts that interest rates will rise, forcing the government to spend much more on simply paying interest on its debt. The federal government now pays an average of 2.4 % to borrow; in three decades, the CBO predicts that this will rise to 4.2%.

If true, that will cause an exponential increase in the amount the government has to pay for debt service.

By the 2040s, the CBO projects, the primary budget deficit—the gap between non-interest spending and tax revenue—will stabilise at less than 4% of GDP, but net interest will keep on rising. This is because as the government borrows more and more to cover its interest payments, the amount of debt that's accruing interest goes up.

In many ways, this is actually a very conservative forecast. The CBO assumes that the US will raise taxes, instead of cutting them as it has done repeatedly. It assumes no future recessions requiring large increases in the level of federal debt for stimulus purposes. And most importantly, it assumes no big future increases in discretionary spending and no new big entitlements. If Medicare For All or the Green New Deal ever make it through Congress, the projected federal debt will be much, much higher.

Why is this a problem? If the government decides to cut deficits by raising taxes even more than the CBO predicts, it could slow the economy. If it decides to let the debt grow, it will have to borrow more and more in order to cover its increasing interest, and both borrowing and interest costs will snowball. That could provoke what the CBO calls a fiscal crisis—a private investor panic about the government's ability to repay its debt, causing a drop in bond prices that render financial institutions insolvent and causing an economic crisis.

The government thus has a good reason not to let debt spiral out of control. And the easiest way to keep that from happening is for the Federal Reserve to cut interest rates to zero and keep them there. As the government replaces its old, higher-interest debt with new, lower-interest debt, its yearly interest payments would go down, until finally they dwindle to nothing at all. Doing this would stabilise the deficit, and even open up fiscal space for big new spending initiatives on issues like climate change.

This situation—where the central bank holds rates at or near zero in order to keep the government solvent—is known to economists as fiscal dominance. Arguably, Japan has been in this situation for years.

Some argue that Japan's interest rates are low for natural reasons, mainly because of population decline and slow productivity growth. But Japanese central bankers' periodic intentions to raise rates have probably been restrained by the country's enormous public debt. Even if they wanted to, Japanese policy makers couldn't raise rates very much without the spectre of government insolvency.

Most macroeconomists think this isn't much of a problem. Inflation is the traditional reason to raise rates, and Japan doesn't have much of it. But there's a possibility that long periods of low interest rates have negative consequences that don't appear in traditional economic models. For example, low rates might encourage the survival of unproductive zombie companies, or it could allow monopolies to dominate markets with cheap borrowing. These potential downsides are not well-researched or well-understood yet.

The US might also not be the same as Japan. Its investors could be more inclined to abandon the country for greener pastures if rates stayed too low for too long. With population expected to grow instead of shrink, the US also might not be able to sustain zero rates forever without eventually risking inflation.

So the US shouldn't stride confidently into a brave new world of fiscal dominance just because Japan hasn't yet collapsed. Just to be on the safe side, other measures to constrain deficits—reducing excess cost growth for health care and reversing recent tax cuts—would be prudent. But should these efforts turn out to be politically impossible, get ready for permanent zero interest rates.

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LETTERS TO THE EDITOR

Discount on petrol/diesel

To encourage cashless transactions post demonetisation, the union government has started giving several discounts onuse of credit and debit cards, including a 0.75% discount on card-based purchase of petrol and diesel and online payment of insurance premiums. Due to inadequate publicity, it is not clear which discounts are still applicable. The currency position having normalised, the union exchequer should not be burdened with such discounts anymore. Instead, steps should be taken to ensure that banking is made less expensive; transaction charges, charged to sellers on payments received through credit or debit cards, should be paid from the public exchequer at a reduced rate than the present 2%. To minimise currency circulation, consolidated steps, such as limits on monthly cash withdrawal from banks for individuals, should be taken.
— Subhash C Agarwal, Delhi

Refugee crisis

The heart-rending image of father and daughter, migrants from Ecuador, lying dead on the banks of the Rio Grande river at the US-Mexico border tells the horrific and pathetic plight of scores of hapless migrants fleeing violence and bloodshed in their homelands. The trend of perceiving refugees as a threat to national security and local culture is truly despicable. Trump's description of Hispanic immigrants as rapists and criminals sums up his attitude towards immigrants. The politics that seeks to prop up the bogey of the migrant with a poor understanding of citizenship across the globe needs to change.
— M Jeyaram, Sholavandan

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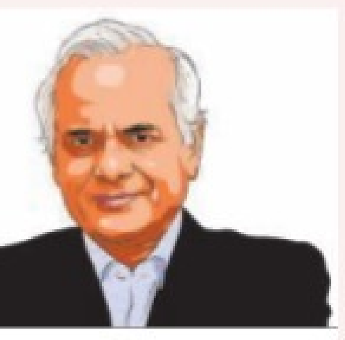

OVER THE BARREL

How India can de-escalate US-Iran stand-off

The US-Iran stand-off is wrapped in a "fog of uncertainty." No one knows what will happen, but what we do know is it could take no more than a false report, a miscalculation or an accident for the region to conflagrate into violent conflict. India would be severely impacted in such an event

THE MOST BASIC FORM of human stupidity is forgetting what we are trying to accomplish." This Nietzschean aphorism finds sharp affirmation in the behaviour of the leaders of US and Iran today. Both have forgotten what they are trying to achieve, but both are engaged in verbal, economic and physical jousting that is generating sparks that could light up a regional bonfire. India would be severely impacted in such an event. Our leaders face a policy dilemma. Should they use their "soft" power to try and snuff out the sparks, but risk possibly an embarrassing rebuff? Or should they stay on the sidelines in the hope that disaster will not prevail? It is my view that the Indian government should do the former. It should deploy the "quiet" power of diplomacy to pre-empt the consequences of human stupidity.

The signals emanating from Washington DC and Tehran are confusing and blurred. They suggest that the leaders in these two cities have lost sight of their vital objectives.

American President Donald Trump says he does not want war; that he is not looking for a regime change, but only a tighter nuclear agreement. He says his objective is to ensure Iran will never acquire the capability to develop nuclear weapons. But he also tweeted the word "obliterate" to define the range of options that remain on his table; the US National Security Advisor John Bolton and Secretary of State Mike Pompeo have stated that war is an option, and their preferred outcome is, indeed, a regime change.

The Iranians are also conveying mixed messages. Their elected leadership wants to exercise "strategic moderation" and remain compliant with the Joint Comprehensive Plan of Action (JCPOA). They are hopeful that with the support of the Germans and the French, the crisis can be settled through negotiation. The Islamic Revolutionary Guard Corps (IRGC), on the other hand, wants the government to breach the uranium stockpile limits agreed to in the JCPOA (the 2015 Iran nuclear deal) and to enrich uranium to 20% purity (which is just one step away from weapon-grade material). They also want to signal, through direct and indirect action, that they will not be bullied by the Americans. The Ayatollahs generally keep their cards close to their chest, but given the Iranian economy is in free fall—GDP fell by 4% last year and an additional 6% this year, inflation is running at 30%, food is in short supply, the currency is on skids, and unemployment is at record highs—they, too, are inclined to play the US "Satanic" card to divert public attention away from the domestic crisis.

> India should persuade Iran to revert to its original position of remaining within the framework of the JCPOA, and deny the hardliners on American side the *raison d'etre* for escalation

There is an explanation for this political amnesia. The leaders are wrestling to reconcile their international priorities with their domestic constituencies. The problem is that, in the process, they are pushing the region towards large-scale conflict. And that is why their actions fit so neatly into the Nietzschean mould of stupidity.

Students of military history will not be surprised by this drift towards war. Trump is, alas, no such scholar. Had he been so, he might have remembered the forewarning contained in the unfinished magnum opus of the Prussian General Carl von Clausewitz, '*Vom Kriege*' (*On War*), that "three quarters of the factors on which war is based are wrapped in a fog of greater or lesser uncertainty." He may have noted the mind-boggling confirmation of this observation in the memoirs of the former US Secretary of Defense Robert McNamara, who wrote that "President Johnson authorised the bombing (of North Vietnam) in response to what he thought had been a second attack that had NOT occurred." The "attack" referenced was on the American destroyer USS Maddox by North Vietnamese patrol boats on August 4, 1964, in the international waters of the Gulf of Tonkin. In fact, two days earlier, destroyer USS Maddox had been attacked by the North Vietnamese. The report of a second attack inflamed the US Congress, who then passed the Gulf of Tonkin Resolution, which was a de facto declaration of war against the North Vietnamese. It was later established that the report of a second attack was erroneous. This is difficult to believe, but this means that the US went to war in Vietnam on the basis of erroneous intelligence.

The US-Iran stand-off is wrapped in a "fog of uncertainty." No one really knows what will happen, but what we do know—based on our reading of von Clausewitz and our understanding of history—is that it could take no more than a false report, a miscalculation or simply an accident for the entire region to conflagrate into violent conflict.

India would be severely impacted in such an event. It imports 65% of its crude oil from the region. Conflict would disrupt its oil supply lines and harden oil prices. Moreover, there are approximately 8 million nationals living and working in the area. Many of them would need to be evacuated. This would present a major logistics challenge. But more worrying and beyond these immediate ramifications is that India and Indians would feel the tremors of the aftermath of such a conflict for a long time.

The question, therefore, for India is: Should it allow history to repeat itself? Or should it make an effort to stave off disaster beyond the opportunistic bilateral discussions that it has already had with Pompeo and Trump. In my view, it should take that extra step. This is not simply to safeguard its economic interests. It is also because India is strongly placed to arrest this dangerous drift. The country has long-standing historical and cultural links with the Middle East and, in particular, Iran. Prime Minister Narendra Modi has enhanced international stature because of his massive electoral victory and strong personal relations with his counterparts in the region. And foreign minister Subrahmanyam Jaishankar is a superb and world-class diplomat. Together, this makes for a rare combination of "soft", "smart" and "quiet" power. India should deploy this combination towards one objective. To persuade Iran to revert to its original position of remaining within the framework of the JCPOA, and to deny the hardliners on the American side the *raison d'etre* for escalation.

DIRECT TAXES CODE

From convoluted to coherent?

GAURAV MEHNDIRATTA

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An attempt towards a concise, coherent and consolidated direct tax structure

"The nation should have a tax system that looks like someone designed it on purpose"—William Simon.

WITH A STABLE GOVERNMENT at the Centre, stage is set for introduction of reforms needed to put the economy back on high growth trajectory. The NDA, in its previous term, demonstrated resolve to push through bold reforms as well as discard old laws. Taxes have been a focus areas and a major reform on the tax side was transformation in indirect taxes with the GST, which subsumed within its ambit 17 state and central indirect levies. On the direct tax side, the Wealth Tax Act, 1957, was scrapped and a panel constituted in November 2017 to rewrite the existing Income-tax Act. The panel is expected to submit a report to the government by July 31, 2019. In the Union Budget on July 5, it is expected that a framework for introduction of the direct taxes code (DTC) will be laid down.

The Income-tax Act was introduced in 1961, but has failed to keep pace with evolving businesses and a fast-growing economy. Some instances in the past have highlighted deficiencies in this Act to bring to tax certain transactions that the government intended to tax. Another example is of digital businesses, which can potentially result in significant tax leakages and has also been focused upon by the OECD in its Action Plan-1 on Base Erosion and Profit Shifting project.

While the government has tried to keep the Income-tax Act at pace with evolving business realities by bringing in suitable amendments—taxation of indirect transfers of Indian entities, equalisation levy on online advertisements, thin capitalisation rules, GAAR and certain other provisions through annual fiscal budgets—the provisions seem to have been rushed into existing overall schemes of the Act (except for equalisation levy that is outside its scope) and, thus, have led to interpretational issues, leading to potential for serious tax litigation. Transformation of the Income-tax Act into a new tax regime that is aligned with current economic realities and modern businesses is the need of the hour.

DTC is an attempt to make it a concise, coherent and consolidated direct tax structure. The UPA had also attempted to bring in DTC and introduced the first draft Bill in 2009 and a revised version in 2014, but the idea of DTC was shelved shortly after the change of government.

The economy is going through a rough patch. Introduction of tax incentives and cutting tax rates have been used as a tool to reignite growth—India has one of the highest corporate tax rates amongst big economies. DTC is an opportunity to rationalise tax rates as well as introduce provisions to incentivise high-growth sectors such as IT/ITeS, retail, e-commerce, etc. Further, given the minuscule amount of R&D in India and its relative importance, there have to be incentives for R&D activities as well as simplifying existing incentives such as preferential tax rates for income from exploitation of patents developed in India. Providing certainty to foreign and domestic investors by minimising tax litigation is another focus area for DTC. Although we have the Authority for Advance Rulings, its attractiveness for obtaining tax certainty has reduced, largely due to many AAR applications pending for disposal, courtesy the lack of administrative capacity to handle the number of applications being filed and AAR being non-functional for most part of the year. DTC should address this by adopting a comprehensive dispute resolution method by bringing in an advance authorisation process. For example, in many countries, tax authorities generally answer inquiries made by taxpayers even without a formal ruling procedure, and in others there is advance statutory back-up procedure for pronouncing such rulings.

DTC should incorporate certain other practices, too. One such is the provision in the US tax law that provides for joint filing of returns by married couples, which leads to both reduction in taxes and compliance for taxpayers. In Singapore, information for salaried employees is auto-included while filing tax returns, and requires only validation, making the exercise of submitting a tax return quicker and simpler.

DTC is going to be one of the most important tax legislations as it will replace not just the Income-tax Act, but also possibly tax jurisprudence of the last 60-odd years. As has been witnessed in the past, hurriedly-drafted tax provisions serve neither the taxpayers nor tax officials well, and hence the government would do well not to rush early introduction of DTC but allow adequate time to both legislators to draft and stakeholders to debate the new law. The requirement of a new direct tax regime is real and immediate.

DUNNING-KRUGER EFFECT

The cognitive bias

Can ineptness rob people of the mental ability to realise just how inept they are?

VIDYA HATTANGADI

The author is a management thinker and blogger

THE DUNNING-KRUGER effect is a cognitive bias in some people who have an inflated notion about their capabilities. Their self-assessment with regard to their knowledge and decision-making reaches elusive heights. They make erroneous decisions. When such people take important leadership positions, they obstruct progress of the organisation. Their misconceptions about themselves with regard to self-cognitive abilities blinds them from seeing errors; also, their incompetence denies them to recognise others' strengths. The concept was coined in 1999 by Cornell University psychologists David Dunning and Justin Kruger; the eponymous (named after persons) Dunning-Kruger effect is a cognitive bias. Incompetent people have an exaggerated notion about their knowledge and intelligence, it blights results and sometimes such results take decades to correct.

I take the example of India's first Prime Minister Jawaharlal Nehru's decision of referring Kashmir to the UNSC. This action negated the Instrument of Accession signed by Maharaja Hari Singh. Even till today, the Kashmir issue remains sticky. Besides India and Pakistan, it has many sides: the five regions of Kashmir and numerous political organisations.

Charles Darwin said that "ignorance more frequently begets confidence than what knowledge does." I am sure most of us would have experienced frustration by the incompetence of another person in our professional and private lives. The frustration increases when these incompetent people do not recognise their own limitations. Incompetent people tend to overestimate their own levels of skills and they fail to recognise genuine skills in others.

Hitler's '*Mein Kampf*' showcases his total lack of insight into his own limitations. A budding narcissist, Hitler's recounting of his schooling describes his propensity to argue with adults despite not having yet received his education. This is an apt example of his cognitive bias.

In an experiment, Dunning and Kruger asked 65 participants to rate how funny different jokes were. Some participants were exceptionally poor at determining what other people would find funny, yet these same participants described themselves as excellent judges of humour. The research found that incompetent people are not only poor performers, they are also unable to accurately review and recognise the quality of their own work. The low performers are unable to recognise the skills and competence levels of others, which is part of the reason why they every time view themselves as better, more capable and more knowledgeable than others.

This might be the reason why some students who earn failing scores in exams at times feel they deserved a much higher score. They overrate their own knowledge and ability, and are incompetent of seeing the mediocrity of their performance.

In 1708, Sweden invaded Russia during a winter so fierce that even Venice's port froze. The invaders lost 16,000 men in that particular push. Just over 100 years later, Napoleon also attempted an invasion that began in the summer. By late fall, he'd lost thousands of soldiers and, although he succeeded in occupying Moscow, he eventually had to retreat. The most famous example, however, is of the Second World War. Hitler believed he could take Russia before the onset of the winter—and his army wasn't ready when the Russian winter finally did come. In fact, things went so poorly in Russia that Hitler lost about 750,000 men before November.

Dunning and Kruger put forward that this phenomenon stems from what they refer to as a "dual burden." People are inept, and their ineptness robs them of the mental ability to realise just how inept they are. The least skilled people often overrate their ability because they have no idea how much they don't know. In other words, poor performers believe that they know everything on a particular subject and, therefore, they tend to be bombastic about it. In contrast, high performers are aware of the enormity and intricacies of the field they are working in. They know how much they don't know, and thus they usually underestimate their ability and competence in a particular area.

The Dunning-Kruger effect also has to do with what scientists call metacognition. It is described as "cognition about cognition," "thinking about thinking," and "knowing about knowing." It is a higher form of cognition; to be aware of the awareness itself. A person with a high level of metacognition is able to become aware of his or her thought processes and view them from different and fresh perspectives. This cognition about cognition allows them to analyse and judge their ideas, knowledge and skills more accurately compared to people who are having difficulties with metacognition.

The world is filled with incompetent leaders in all fields; often, leadership positions seem glamorous but the crude reality is that many leaders hardly make any effect on their teams. When stupid leaders run a country, an organisation, a hospital, a school or a university, they weaken the foundations. If someone is going to run a country properly, he/she needs to be an expert at collecting viewpoints, appointing experts and sieving through them to produce effective and well-judged policy objectives that actually work. In the absence of that sort of expertise, only chaos will be created. Aren't we seeing this happening in most parts of the world?