

# Danger signals for regulation

In the name of reducing the burden on the airport regulator, has the government expanded its own role?



RAISINA HILL

An unhealthy precedent appears to have been created by the Modi government in the way regulation of sectors is undertaken. If the sector has grown rapidly and several private players are entering it in partnership with public sector entities, then the scope and powers of the independent regulator can now be curtailed on the apparently specious ground that the burden on it must be reduced.

This is exactly what happened when the government got the Airports Economic Regulatory Authority of India Act, 2008 amended in Parliament last week. Two specific features of the earlier law have been modified through the 2019 amendment. One pertains to raising the threshold for defining major airports, which come under the purview of the Airports Economic Regulatory Authority (AERA). The second change exempts from AERA's purview all airports, won by operators on the basis of tariff-based bidding or pre-determined tariffs.

India has 102 airports, of which 7 are joint-venture international airports (like those in Delhi and Mumbai), 20 are international airports, 60 are domestic airports, 8 are Customs airports and 7 are state government or private airports. Of these, only 33 airports came under the purview of AERA, since the annual passenger traffic they handled was more than 1.5 million.

But that was only till the amendment of the AERA Act last week. The amend-

ed law mandates that AERA would regulate only those airports, whose annual traffic is more than 3.5 million. Going by the traffic numbers in 2018-19, this would halve the number of airports to be regulated by AERA to just 16.

The government, of course, argued in Parliament that this did not reduce the scope of regulation. When the law was enacted in 2008, the criterion of 1.5 million to define a major airport was fixed keeping in mind that the threshold resulted in bringing under AERA regulation only about 1.3 per cent of total airport traffic at that time. The traffic has grown significantly since then and the new threshold of 3.5 million accounts for much more than 1.3 per cent of the total traffic at present. So, according to the government, there is no dilution in the scope of the regulator.

However, the problematic logic behind the decision becomes evident when one reads the Statement of Objects and Reasons, appended to the amendment Bill. It stated: "Exponential

growth of the Sector has added tremendous pressure to the Authority on the one hand and various private operators are entering the Sector in the form of Public Private Partnership on the other hand, which requires regulatory certainty keeping in view long gestation of the Sector. To overcome this complexity, it is felt that if too many airports come under the purview of the Authority, it will be difficult on the part of the Authority to efficiently determine the tariffs and monitor the service standards of major airports with the limited resources available with the Authority."

Similarly, all airports to be awarded on the basis of pre-determined tariffs or tariff-based bidding would no longer be regulated by AERA. Of course, AERA would be consulted in advance on such tariffs, but effectively the regulator would have no role in determining tariffs for such airports every five years or periodically, as it does for other airports. The government has argued that in such a tariff-based model, "the market itself determines the charges and the regulator is not required to fix charges after the award of the project". This is disturbing as even though the market may fix the tariffs, tariffs needed to be monitored and regulated periodically by an independent regulator. And the proposed system seems to do

away with such regulation during the period of the contract.

AERA should see the writing on the wall, as its role will get further reduced. The Statement of Objects and Reasons of the AERA amendment Bill makes it very clear while referring to the role of the tariff-based model for airport development: "Since this model is a means to reduce the airport charges, the airports in future may also be developed under this model."

Many deeply troubling questions arise. If AERA was overburdened with the task of regulating 33 airports, why didn't the government explore the easier options of strengthening the regulator? By shifting the regulation of 17 airports (Calicut, Srinagar, Coimbatore, Amritsar, Mangalore, Varanasi, Port Blair, Trichy, Nagpur, Kannur, Vizag, Bagdogra, Chandigarh, Madurai, Indore, Ranchi and Raipur) outside AERA's purview, has the government expanded its own role? After all, the government controls the Airports Authority of India (AAI), a state-owned entity, which will now oversee these 17 airports as well. Will AAI have the capacity to carry the additional responsibility? Or were the changes in the law a sweet deal for the new private sector airport operators? And finally, will this regulatory principle used in the aviation sector be applied to other sectors as well?

## CHINESE WHISPERS

### Spoilt weekend



Officials scurried to office over the weekend after a sudden order from the PMO to all departments on Friday to give details of the work done in the first 50 days of the new government. This had to be released to the press. The government had set a 100-day target, so the 50-day compilation took them by surprise. Officers were found poring over mounds of files to fill in details of their achievements.

### Battle over Sita-mata



The Congress, the ruling party in Madhya Pradesh, and the Bharatiya Janata Party are in dispute over a temple the state government has promised to build in Sri Lanka. Former chief minister Shivraj Singh Chouhan promised to construct the temple but the matter did not go beyond the planning stage. PC Sharma, minister in charge of religious trusts, recently said the government would build the temple and do a survey before starting the project. To that, Chouhan tweeted, "Kamal Nath sarkar ke afsar Sri Lanka jaake survey karake verify karengi ki Sita mata ka apharan hua tha ya nahin. Mitron isse jyada hasyaspad kya ho sakta hai." (Officers of the Kamal Nath government will visit Sri Lanka and conduct a survey to verify if Sita *mata* was abducted. Nothing can be more ridiculous.) He accused the state government of hurting the Hindus by announcing it would "probe" things that were held as "undeniable truths".

### Achche din for MP MLAs

The Madhya Pradesh government has decided to give MLAs ₹50,000 in cash to purchase laptops. They can buy the brand they like. The government will also increase the amount of the vehicle loan from ₹15 lakh, which the previous regime offered, to ₹20 lakh. The house loan amount has been raised to ₹20 lakh from ₹15 lakh. The government has sanctioned a personal assistant for each MLA against the demand for two. All this despite the government being financially weak.

# Can Gill play a Pandit for YES Bank?

The YES Bank CEO must raise as much capital as he can, keeping his eyes closed at what price it is coming



BANKER'S TRUST

Last Thursday, shares of YES Bank Ltd slumped close to 15 per cent to hit a new 52-week low as many brokerages rushed to say "no" to the bank's stock after the lender's June quarter earnings missed analysts' estimates and the pile of bad loans continued to rise.

The stock's woes started in June after Swiss brokerage UBS maintained "sell" rating on it and cut the target price to ₹90 from ₹170, citing weak earnings going ahead. On Thursday, the stock touched an intraday low of ₹79.15 on the National Stock Exchange.

The good news is unlike in the past, the new management of the bank, led by Ravneet Gill, does not seem to be contemplating any legal action or even complaining to the market regulator against UBS! Going by the Bloomberg data last week, 15 brokerages say yes ("buy") to the bank, 15 "hold" and 17 no ("sell"). Many have revised the price target downwards.

In the June quarter, the private

lender reported a 91 per cent decline in its net profit to ₹113.76 crore from ₹1,260.36 crore a year ago. The quality of assets deteriorated — the gross non-performing assets (NPAs) as a percentage of total loans rose to 5.01 per cent from 3.22 per cent in the March quarter and after setting aside money or provision, the net NPAs rose to 2.91 per cent from 1.86 per cent. The addition in the pile of bad loans had been ₹6,230 crore in the June quarter.

The real shocker was its March quarter earnings — the first-ever quarterly loss of ₹1,506.64 crore as it had to make huge provision to take care of bad assets. But for a ₹832 crore tax write-back, the loss would have been much higher. Total provisions in the March quarter rose nine-fold to ₹3,661.7 crore from ₹399.64 in the year-ago quarter and almost seven times of the December quarter. Other highlight of the March quarter was a sharp drop in fee income.

That trend continues but there are pointers from which the analysts could take heart. For instance, the retail deposits have grown, signifying that the customers have not lost trust in the bank. The retail advances have grown over 43 per cent year-on-year; they account for more than 60 per cent of the incremental growth in advances. As a portion of the overall loan book, the retail book is still small compared with other private lenders but it has grown from 14 per cent to 18.3 per cent in past one year. Even though the fee income is sharply coming down, the revenue earned from the sale of others' insur-

ance products has risen. The fee income will never be the same again as Gill is refraining from booking it upfront, as had allegedly been the practice earlier, and shifting focus from corporate to retail loans.

The rise in bad loans is mostly from those accounts (worth ₹10,000 crore) which have been under the watch list of the bank and the larger chunk of its sub-investment exposure. In that sense, there is not much of a negative surprise. In the past, we had seen rising bad loans in other private lenders from accounts that were not identified as stressed.

However, there are concerns. One of them is the relatively low provision coverage ratio — 43.1 per cent. It was 60 per cent, two years ago; and 55.3 per cent a year ago. The low-cost current and savings account or CASA also dropped by 5 percentage points — from 35.1 per cent of overall deposits in June 2018 to 30.1 per cent in June 2019.

The biggest concern is over capital. Indeed, its overall capital adequacy ratio is 15.7 per cent and the Tier I capital is 10.7 per cent but the core capital or the so-called common equity Tier I or CET1 is down to 8 per cent. This, according to a Credit Suisse report, equals 35 per cent of the bank's bad loans. It can sell down assets but that's not a solution to the problem.

In August 2012, in a speech at the Lee Kuan Yew School of Public Policy in Singapore, Vikram Pandit, former CEO of Citigroup, had said: "To me it is clear in hindsight that, crisis or no crisis, Citi had to be restructured. The crisis was



the catalyst but the need was there... When I became CEO in December of 2007, figuring out what to do was the easy part. I knew we had to get back to the basics of banking... I assembled a core team... We immediately began raising capital. Since year-end 2007, we've added more than \$140 billion to our capital base... And we changed the structure by identifying what businesses were core and which were not core to our strategy and historic strengths... And our risk management function has been completely overhauled..."

In 2009, the Citi stock was on the verge of becoming a penny stock. Pandit brought back the bank from the graveyard. YES Bank is in no way comparable with Citibank but Gill's challenges are similar. In an interview with this paper in June, he had pegged the total capital requirement for the bank at little north of \$1 billion. He has also said that ideally he would not like to dilute equity at "such a low price" but he would do what needs to be done in the best interests of the bank.

That's the right approach. He has nothing to lose as he is not the promoter of the bank. He must raise as much money as he can, keeping his eyes closed at

what price the capital is coming. Gill exudes confidence on envisaging the credit losses that the bank may have to book but can he guarantee that there aren't any more skeleton in the closet? Will the investors get excited if YES Bank needs to come to market again, after a year? Citi was bailed out by the US government through its Troubled Asset Relief Program; Warrant Buffet stepped in to rescue Goldman Sachs and Merrill Lynch. Gill needs to identify the White Knight for YES Bank.

Running a bank without sufficient capital is akin to driving a car without fuel. Even a BMW X7-owner doesn't have any choice but to garage the car if it runs out of fuel. A great franchise is useless if a bank doesn't have sufficient capital.

Enjoying the backing of the regulator, Gill has identified the core problems, ring-fenced the banks from "influencers" and is in the process of building a new team. Now, he needs to play a Vikram Pandit for YES Bank.

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## INSIGHT

# Shift gears... now

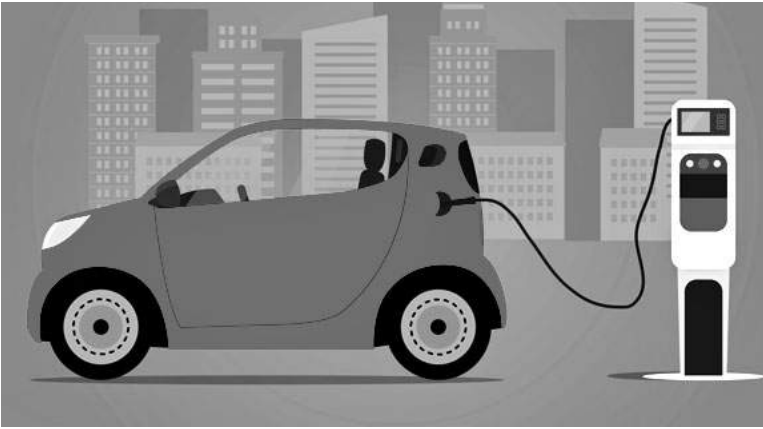
Early EVs had been expensive, heavy and had limited driving range but new technologies are making them affordable and popular



MURAD ALI BAIG

All revolutions are not political. Some are mechanical. The steam engine fundamentally changed human lives then automobiles began to replace horses. Now electric vehicles (EVs) are revolutionising global mobility but most people remain skeptical. Last year 5.6 million EVs were sold globally, of which half were sold in China. Actually the EVs recorded concerned cars and China is actually using many more electric two-wheelers. EVs are also becoming very important in USA, Europe, Japan and other countries so every auto major in cars, bikes and other vehicles is investing heavily into developing and marketing them. The Nissan Leaf, that sold 3,60,000 EVs last year, is the world leader today though the classy Tesla, that sold 240,000 EVs is perhaps the best known. Other well known brands are selling well. Toyota and VW are even working together on EV development.

The world now recognises that some 900 million vehicles fueled by fossil fuels are major polluters but more importantly the industry realises that fossil fuel vehicles are doomed because EVs are much more efficient than internal combustion (IC) engines and thus cheaper to own and use in



the long term. Many people however have had reservations in adopting this new technology because many of the early EVs had been very expensive, heavy and had limited driving range but better new technologies are now making EVs affordable and popular.

An IC engine is inherently inefficient as it has to waste about 70 per cent of its power to suck in the fuel in one cylinder, compress it in another and then expel the exhaust gasses from a third. It has to also waste energy in a gearbox, cooling system, turbo chargers, etc. An electric motor just spins efficiently in one direction so that almost all the energy is delivered to the wheels. This difference in power efficiency means that the torque, or power delivery, of a 100 hp electric motor is roughly the same as a 300 hp IC engine but a typical 100 hp IC engine delivers 100 hp only at its maximum rated speed and normally operates at about a third of this peak power unlike an electric motor that delivers a constant power output. So an EV can quickly accelerate from standstill to top speed without any need of gears. But an EV

makes no sound so it needs a sound generator to warn other road users.

India today has more than 20 makes of e-rickshaws, about five electric scooters and 10 electric motorcycles that are mostly made in the unorganised sector using kits mainly imported from China that has vigorously adopted EVs. Today almost all their two-wheelers including pedal cycles are electrified. China went further and also became the world leader in solar energy with huge exports of solar panels.

The recently launched Hyundai Kona SUV clearly demonstrates the experience of driving a luxurious modern electric car. It looks a bit like a Hyundai Creta but its small electric motor has a huge torque of 40.27 kgm that delivers roughly as much power to the wheels as a big 2,800 cc IC engine at full throttle resulting in furious acceleration from standstill to 100 kmph in just 9.7 seconds.

It can also travel a huge distance of about 450 km on a full charge. The charge from a domestic electric point may need 19 hours but a wall mounted

AC (alternating current) system will give a full charge in 6 hours. A portable DC quick charge device (provided with the car) can however provide an 80 per cent charge in 57 minutes. Best of all the electric consumption for a full charge will be just 39 units of electricity that would cost just ₹200 or roughly 20 per cent of the price of equivalent fuel for a diesel engine. Buyers who are concerned about the life of the expensive lithium-ion battery pack will be reassured that Hyundai is offering a huge eight-year warranty with virtually unlimited mileage. As there are so few moving parts there is also very little need for service during its lifetime. Hyundai has already sold over 300,000 electric cars worldwide and knows that what happens elsewhere in the world will also happen in India eventually.

Heavy transport vehicles travel long distances with big engines that consume huge quantities of fuel. The country will need a network of recharging stations for electric trucks and buses but instead of recharging points they can use swapping stations where the complete battery pack can be quickly removed and replaced with another pack.

In the recent Budget the government announced steps to encourage EVs by reducing the GST from 12 per cent to 5 per cent and concessions on customs duty on the imported components. There are however no subsidies and the huge savings in fossil fuel consumption, foreign exchange savings and reduced pollution justify more subsidies.

When EVs become popular there will be a big reduction in the imports of petroleum products though they will still be needed for the existing cars, bikes, trucks, tractors and buses. It may take another decade before all the IC engines are scrapped. This event will also mark the economic decline of all the oil rich countries with a huge reduction in pollution. Global warming may slow down to stabilise world weather, stop the melting of the glaciers and save the environment.

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## LETTERS

### More tax, less gain?

Dhiraj Nayyar in his article "Cake or taxes?" (July 18) argues for bringing down the total tax liability of the very rich and super-rich (earning more than ₹2 crore) in India, from 39 per cent and 42.5 per cent to 30 per cent, on par with the corporate tax. I agree with the first part but not the latter. The surcharge, being a tax on tax, is an illogical way of raising government revenue and in respect of the richest has been going up every year beginning with 10 per cent in 2013. It is unethical also because it is a devious way of depriving the states from their share of the taxes.

The government expects to get just ₹2,724 crore but its adverse psychological effect will be much more — it may induce the affected to find legal (forming limited liability partnership) and illegal (tax evasion) means to reduce the liability. Also, there are doubts being raised about its negative impact on foreign portfolio investors.

However, should tax on individuals be on par with corporates? Corporations spend a part of their profits on discharging corporate social responsibility; individuals may not. Even as they add to their income, corporate activities provide employment to a large number of job seekers, contribute to GDP growth significantly and produce goods and services that by and large benefit the society. Individual entities may not match these gains to the nation. Besides, there is likely to be a high concealment of income in the case of non-salaried assesses.

Y G Chouksey Pune

### Fundamental issue

This refers to "How raters played ball with IL&FS brass" (July 20). The Grant Thornton report shows very disturbing things. The concerned credit rating agency was allegedly influenced and threatened to maintain/modify/delay the ratings of IL&FS despite its very steadily deteriorating financial position. Earlier there were reports that executives of credit rating agencies were allegedly materially induced for this purpose.

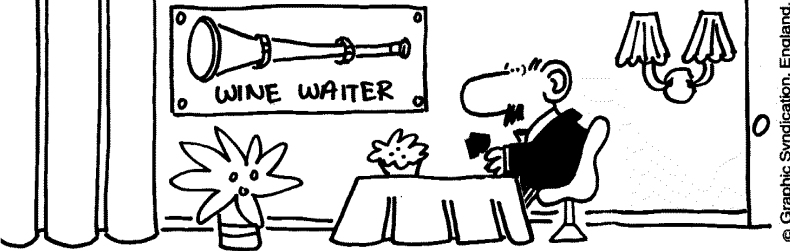
This raises fundamental issues in the financial system. If auditors can be induced to gloss over serious irregularities and give reports that do not reflect the true financial position of a company and credit rating agencies can be forced to give favourable ratings despite bad financial conditions of companies, what is the sanctity of auditing and credit rating processes?

Based on audit reports and credit ratings, everyone takes crucial decisions. These decisions will be based on false premises because of dodgy audit reports and false credit ratings. The government and regulators need to move quickly to set right these anomalies in the financial system. Otherwise, stakeholders in the country and investors abroad will lose respect for these processes in our financial system.

Arun Pasricha New Delhi

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## HAMBONE



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# A killer judgment

India must guard against perverse bankruptcy judgments, such as the one on Essar Steel

All hell broke loose in India's legal and banking circles after the National Corporate Law Appellate Tribunal's (NCLAT's) decision in the Essar Steel case on July 4 this year. The 116-page judgment, written by Justice Sudhansu Mukhopadhyay, chief of the NCLAT, has turned the fundamental tenets of bankruptcy restructuring upside down.

The commentariat's views have been universally negative. One headline screamed "NCLAT's Essar Steel ruling negates the rights of secured creditors, makes mockery of the IBC [Insolvency and Bankruptcy Code]". Another wrote of "The Possible Perils of NCLAT's Verdict". Yet another cried "NCLAT gets it totally wrong on Essar Steel". Rajnish Kumar, State Bank of India chairman, has said that lenders will be moving the Supreme Court against this order.

What is this offensive order? Where does it stand vis-à-vis the IBC and globally accepted norms of desirable bankruptcy procedures? These are some questions that I shall answer here.

Bankruptcy is about debt default. Since debt is a contract between a borrower and a lender that must be adhered to irrespective of whether the former can service such debt, a universal principle of bankruptcy is that the lenders' unpaid dues have to be settled in full before entertaining those of other claimants.

Within debt, there is a well-defined hierarchy of claimants. First come the claims of secured creditors — typically banks and financial institutions — that have a charge on the debtor's assets against their loans. The IBC calls them "secured financial creditors". If there is any residual left after their claims, then come the unsecured creditors, who are trade creditors, government agencies with unpaid bills and dues of workmen — all having creditor rights, but no access to any security. Under the IBC, they are called "operational creditors".

There are two reasons why secured financial creditors have seniority in claims. From a legal perspective, a lender having security of a borrower's assets must be first taken care of, or else the security will remain with the lender. More importantly, secured creditors are banks and financial institutions, which use public

and depositors' funds to make their advances. Without seniority in claims, the entire edifice of banking faces huge systemic risks. Banks price their secured loans at a lower rate precisely because of their lien on the borrowers' assets. Without that, they would charge much higher interest rates.

Now for bankruptcy resolution under the IBC. Two Sections are particularly important. The first is Section 30. It states that the appointed professional who deals with a bankruptcy resolution must ensure that several conditions are met. One is that the amount set aside in the plan for repaying the debts of unsecured operational creditors cannot be less than what would be paid to them in the event of liquidation. It means that if the liquidation value can support ₹X crore towards paying operational creditors, then the resolution plan must incorporate at least that amount.

Other conditions under Section 30 are that: (i) the resolution professional shall present the plan to a Committee of Creditors (CoC) for approval; (ii) an approval occurs if it meets at least 75 per cent of the voting share of the financial creditors — essentially representing that share of outstanding secured debt; and (iii) on approval by the CoC, the plan shall be submitted to the adjudicating authority, which is the NCLT, or the NCLAT under appeal.

Section 31 states that if the adjudicating authority is satisfied that the resolution plan sanctioned by the CoC meets all the requirements under Section 30, it *shall* issue an order approving the plan, which shall be binding on all parties concerned.

Section 31 is where Justice Mukhopadhyay has played a Machiavellian game to show that the NCLAT is not just an authority that *shall* approve a CoC sanctioned plan but that it can substantially alter it as well.

This is what he has done. First, in para 148, he ingeniously interprets a Supreme Court decision to argue that operational creditors be given "roughly the same treatment" as financial creditors — something that goes against the grain of the IBC and bankruptcy. Second, in para 149 and thereafter, he highlights "a huge discrimination" between the operational and



OMKAR GOSWAMI

# Markets shocked by Modi 2.0, but why?

The Sensex on Friday crashed by 560 points. From the pre-Budget close of 39,908, this index is now down by more than 1,500 points. There is widespread gloom and doom even though the Sensex is just a little below the all-time high of 40,312, which it touched in late June. If you spend an hour or so on social media, you will hear constant bickering about this government's policies as the reason for the massive wealth erosion, hidden behind the (still) high level of the Sensex. Comments like this abound: "It's not even one month and the entire goodwill of the Modi 2 Govt has been evaporated due to a third rate Budget. Must be the shortest honeymoon in Indian political history."

Last year's big Budget blow was the long-term capital gains (LTCG) tax. This year, it is the tax on dividends, the tax on buyback, the plan to cut the promoter stake to 65 per cent (that increases the supply of shares), and a tax increase of 3 percentage points for individuals with an annual income of ₹2.5 crore and 7 percentage points for those earning more than ₹5 crore. Politicians and officials, living comfortably off the state exchequer, are ordering the rich to make this "small sacrifice" for the poor. We have been used to such demagoguery from Indira Gandhi's regime onwards, but timing matters. While the government wants to extort more money from cash-rich companies and rich investors, it is responsible for the economic slowdown, no job growth, very little incremental investment, and huge increase in its own spending.

## Waking up from a dream world

If the market participants are miffed today, it is perhaps because they were living in a dream world all these years. While Narendra Modi won votes of every segment of the population, he has enjoyed especially unstinted loyalty from the business, and the financial

and investing community. For five years, fund managers, analysts, and businessmen were unanimous in believing every flaky promise of change. They have swallowed every piece of flagrantly fudged data (such as gains from direct benefits transfer) and put it in their own presentations, painting rosy scenarios of growth to investors and financiers. They have cheered every socialistic move of this government as a step towards a new India, when these should have reminded them of the extortive previous regimes.

It didn't strike them as odd that a regime that painted everything about the previous (Congress) governments black would not only continue with the same schemes and ideas, but expand them manifold. For them, demonetisation was a game changer, not mass economic disruption; and bank recapitalisation with no preconditions was a necessary step, not more money down the drain. Most importantly, they have supported every punitive and coercive decision of the government as a necessary building block for a transparent and clean India.

Whether compulsory Aadhaar even for babies, or arrest without a first information report under the goods and services tax, or tax raids without the need to state the reasons, or the argument that citizens have no right to privacy — they only detected strong intent and commitment to cleanse India. Their abiding faith prevented them from seeing that a government that wants to cleanse the system is also slowly destroying the most important transparency tool — the Right to Information Act.

## And then they came for me

The false beliefs now lie shattered. "The government has failed to protect citizens and business from a tax system that has run amok with a broken assessment system and a broken appeal system! No major country has both broken. Tax officials seem to think of every-



IRRATIONAL CHOICE

DEBASHIS BASU

financial creditors made by the CoC in distributing the ₹42,000 crore offered by ArcelorMittal to take over Essar Steel. Third, Justice Mukhopadhyay bizarrely interprets definitions of "financial creditor" and "financial debt" in Sections 5(7) and 5(8) of the IBC to proffer the mother of all arguments: That a financial creditor "cannot be sub-classified as 'Secured' or 'Unsecured'... [in] the 'Resolution Plan'" [para 164] — an interpretation that goes against all tenets of bankruptcy reorganisation or liquidation.

Justice Mukhopadhyay then says while operational creditors cannot be paid less in reorganisation than in liquidation (Section 53), it "does not mean that they should not be provided... more" (para 169). Based on that, he nullifies the allocations made by the CoC, and comes up with an inexplicable "fairness" interpretation — where all creditors, financial or operational, should be treated on a par. (The Mukhopadhyay formula is given below.)

₹(Crore)	CoC proposal	Mukhodahyay's views	Arcelor's offer	Prorated dues (Mukhopadhyay)
Financial Creditors' Debts	49,473	49,473		30,030
Operational Creditors' Debts	5,074	19,719		11,970
Total	54,547	69,192	42,000	42,000

Compared to the CoC proposal, Justice Mukhopadhyay reduces the financial creditors' debt dues by 39 per cent to ₹30,030 crore, and ups those of the operational creditors by 136 per cent to ₹11,970 crore.

This order is offensive because it goes against every tenet of bankruptcy reorganisation. India's *Doing Business* (World Bank) rank was 130th out of 190 countries in 2017; and we were 136th in "Resolving Insolvency". Thanks to the IBC, the rank on "Resolving Insolvency" improved to 108th in 2019; and our overall rank rose to 77th. If Justice Mukhopadhyay's tenets are accepted by the Supreme Court, we will not only regress in modern bankruptcy reorganisation but also slide back in the *Doing Business* rankings.

It is also dangerous because if this exemplifies judicial interpretations of bankruptcy, I can't see international capital either setting up new enterprises or getting to bid for bankrupt firms. In such a scenario, I don't see banks arriving at any expeditious solution to their bad debt problems. Thankfully, the Government of India has moved quickly: On July 17 the cabinet proposed amendments to the IBC that plugs some key loopholes. These should help. Nevertheless, it would be foolhardy to wish away other Justice Mukhopadhyay-like spectres of ill-thought-out judicial activism by Benches that don't understand the logic of bankruptcy processes.

Finally, it is dangerous because of the frustrating "but in a country like India..." problem. Till 1991, we saw hundreds of ridiculous economic decisions justified by the prefix "but in a country like India..." This had dramatically reduced in the last 28 years. Yet it lurks in hidden corners, waiting to pounce. Justice Mukhopadhyay's absurd judgement is one such... indeed, one with profoundly damning implications.

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## No windfall gain

Transfers from RBI are unlikely to change fiscal reality

The government is unlikely to get the kind of fiscal support it was expecting from the Reserve Bank of India (RBI), going by initial comments from members of the expert committee set up to review the economic capital framework of the Indian central bank. The committee ended its deliberations last week after repeated postponements. It was originally mandated to submit its report to the RBI within 90 days of its first meeting, which took place on January 8. The panel was given a three-month extension at that time. Chaired by former RBI governor Bimal Jalan, the committee is reported to have recommended a nominal transfer of surplus capital in a phased manner. The committee is likely to submit its recommendations in the next few days with Finance Secretary Subhash Chandra Garg's dissent note, possibly because of disagreements on the amount and timing of transfers.

The idea of transferring the surplus in a phased manner should be welcomed. Although the contents of the report are not yet public, the transfer from the central bank is unlikely to alter India's fiscal reality in a significant manner. The Economic Survey in 2016 suggested using the central bank's surplus capital for recapitalising public sector banks. The issue became a bone of contention between the government and the RBI last year, which led to the constitution of the Jalan committee in December 2018. Naturally, the government would want a higher transfer because it will help ease some fiscal pressure and increase expenditure in the short run. It is expecting a dividend of ₹90,000 crore from the central bank in the current year.

While it would be interesting to see the committee's commentary on the framework, Rakesh Mohan, former RBI deputy governor and vice-chairman of the committee, highlighted several important issues related to the central bank's balance sheet in an article in this newspaper in October 2018. First, at the net level, the transfer of capital does not create new revenue. It will shrink the size of the RBI's balance sheet. As a result, the central bank would hold fewer securities, which will affect the future flow of income. As Mr Mohan noted: "The longer-term fiscal consequence would be the same if the government issued new securities today to fund the same expenditure." Second, transfers like these can erode confidence in fiscal management. Third, it is important that the central bank has enough capital to appropriately implement monetary policy and adjust to foreign exchange movement, among other things.

Since the transfer from the central bank will, at best, be only a short-term relief, it should be used judiciously to improve the productive capacity of the economy. Transferring capital in a phased manner will allow the government to channelise funds more efficiently. The government would do well to not use this for day-to-day expenses or revenue expenditure because it will not be permanent and affect the future flow of income.

At a broader level, the demand for higher transfer from the central bank, and the fact that a committee is addressing the issue, underlines the fiscal stress. For better fiscal outcomes, the government should evaluate its revenue and expenditure more realistically. Depending on transfers from the central bank or other regulators, higher tariffs on imports, or increasing the marginal rate of income tax for a small minority of rich taxpayers will do more harm than good in the long run.

## A swift response

Govt has moved fast to address IBC problems

Less than a fortnight after the banking and financial system was thrown into turmoil by a decision of the National Company Law Appellate Tribunal (NCLAT) in the Essar Steel case, the Union Cabinet issued a series of amendments to the Insolvency and Bankruptcy Code (IBC) that address some outstanding issues in it. This is a remarkably swift response — not just by the standards of the Indian state but by any objective analysis. The government and the corporate affairs ministry deserve credit for recognising the scale of the problems and moving to address them so quickly.

The NCLAT judgment had, in effect, threatened a core principle of finance: That secured financial creditors get priority over other creditors in the bankruptcy process. The NCLAT had put operational creditors such as suppliers on a par with secured financial creditors such as banks in the distribution of the payoff from ArcelorMittal's purchase of Essar's assets, overruling the decision of the committee of creditors (CoC) regarding the distribution. The banks have appealed to the Supreme Court against the NCLAT judgment, but the Cabinet has acted more swiftly, saying that the IBC will be amended to ensure that the CoC will have the right to take decisions on the distribution based on purely commercial considerations. In other words, priority for secured financial creditors is restored. This will come as a relief to the market. Even beyond these specific circumstances, it is gratifying to know that the government is willing to step in with such speed to address problems in the implementation of what is in many ways its landmark legal and financial reform.

The Cabinet has also tightened the time limit requirements for the successful conclusion of the bankruptcy process. The law as it stands requires the process to be completed in 180 days, with a possible 90-day extension. But resolutions of cases are taking far longer — the Essar matter itself blew easily through that timeline, taking almost two years. The problem is that litigation over various aspects of the decisions being taken in the course of the bankruptcy process is not counting towards that 270-day total. The Cabinet's proposed amendments close this loophole. The government said there would be "a deadline for completion" of the resolution process "within an overall limit of 330 days, including ligation and other judicial processes". There has been widespread concern that the IBC is not working at the speed that has been promised, and the government has attempted to address those concerns.

But that is only part of the story. The underlying reasons why the 270-day limit is being breached also need to be given attention. In particular, there is a severe shortage of capacity in the bankruptcy process. Even when the law was designed, this was foreseen. The original draft of the law provided for a cadre of resolution professionals to ease this capacity constraint. It is not too late for the government to act in that direction. Creating such capacity would further aid implementing this vital and path-breaking reform.

# The Republicans' civil war



## BOOK REVIEW

JENNIFER SZALAI

Over the past month we learned that the US President Trump — who has taken credit for an economic turnaround that began under Barack Obama and a hot streak by the Boston Red Sox — insists that he predicted the meteoric rise of Representative Alexandria Ocasio-Cortez long before anyone else did. He says that he called her "Evita," comparing her to Eva Perón, Argentina's populist first lady, ahead of Ocasio-Cortez's surprise victory in the Democratic primary of 2018.

Last fortnight *The Guardian* disrupted the publisher's carefully scheduled rollout of Tim Alberta's *American Carnage: On the*

*Front Lines of the Republican Civil War and the Rise of President Trump* by leading with this morsel from Alberta's reporting. Before the end of the day, the online furore had run its course — from amplification and distrust to playful irony and political mudslinging. Ocasio-Cortez tweeted out Perón quotes about helping the poor; conservatives gleefully used her tweets to bring up how Argentina under the Peróns became a haven for Nazi war criminals.

It's a sign of the times that Alberta's doorstep volume was at first reduced to a sound bite from the president, who has an uncanny gift for making everything about him. But *American Carnage* isn't just another drop in the deluge of Trump books; in fact, it isn't really a Trump book at all. Instead it's a fascinating look at a Republican Party that initially scoffed at the incursion of a philandering reality-TV star with zero political experience and now readily accommodates him.

Alberta, a political correspondent for the conservative magazine *National Review*

before moving to *Politico*, brings more than a decade of reporting and a real understanding of the conservative movement to *American Carnage*. He reminds readers of the 2000 presidential election, when George W. Bush campaigned with the promise of "compassionate conservatism," reflecting an attempt by the Republican Party to present itself as "warm, aspirational, inclusive," pursuing minority outreach and immigration reform. Republican pollsters had taken a look at the changing demographics of the country, and the numbers spelled doom. The Republican Party simply couldn't survive by catering primarily to white people.

Or could it? This question cuts to the heart of what the party is becoming under Trump, who was the preferred candidate of white nationalists. Trump tapped into and exploited a bigotry that had already been seething, bubbling up to the surface during the Obama administration. Trump might have been a noisy proponent of birtherism, but he was also,

Alberta explains, a "latecomer" to the movement. The Republican adviser Karl Rove says he "knew people, *smart people*, who were into it."

Rove is one of the more than 300 people Alberta interviewed for this book, which locates Trump's ascendancy amid a long-brewing civil war in the Republican Party. The narrative begins with the run-up to the 2008 presidential election, when Sarah Palin — a Trumpian politician before Trump became a politician — was transformed into a national figure by the beloved establishment senator John McCain. Rove calls Palin "vacuous" and an "early warning bell".

Rove's comment reflected a growing awareness among elite Republicans that their grip on the party had been pried loose. What it doesn't do is acknowledge that those who were "experienced and qualified" enough to serve in a Bush administration remembered for expensive wars and the worst financial crisis since the Great Depression might have played a part in their own political demise.

Not that they have all disappeared — far from it. While Tea Party-adjacent Republicans like Eric Cantor and John

Boehner were eventually pushed out by the impatient brawlers of the House Freedom Caucus, certain old-guard figures have since seized on what they need to do to keep their jobs and stay in power. Alberta spells out how Mitch McConnell's refusal to allow even a hearing for Merrick Garland, Obama's Supreme Court nominee, encouraged otherwise hesitant social conservatives — ever hopeful of overturning Roe v. Wade — to hold their noses and vote for a libertine Trump.

Alberta, who thanks Jesus Christ in his acknowledgments, seems truly astounded by the about-face of the evangelical Mike Pence, a longtime free-trade conservative who embraced tariffs after becoming Trump's running mate. The born-again protectionism is one thing, but it's Pence's unlikely portrait of Trump as a pious supplicant that gives Alberta pause. "I respect the sincerity of his faith," Pence told Alberta on the 2016 campaign trail.

"This is when the B.S. detector starts to beep," Alberta writes. His book generally strikes a tone of measured fairness throughout, but he eventually concludes that "Pence's talent for bootlicking" is "obscene." *American Carnage* tells the degrading

story of the ultimate devil's bargain: As chaotic as the current administration is, and as much as the president torpedoes conservative shibboleths like respect for the FBI and the sanctity of families, Republicans have scored some goodies they have long craved — the gutting of environmental regulations, a raft of judicial appointments and an enormous tax cut. The question is how sustainable any of this is. Zac Mofatt, the digital director for Mitt Romney's presidential campaign in 2012, now admits that Romney's hard-line immigration rhetoric may have had some consequences that were less intended than others.

"Sometimes you have to light a prairie fire to win," he told Alberta. "But sometimes it comes back and burns your house down."

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**AMERICAN CARNAGE**  
On the Front Lines of the Republican Civil War and the Rise of President Trump  
Tim Alberta

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