Business 'institutions' essential for India's growth

Like brakes and shock absorbers in a car, society needs cushioning from shocks and volatility

INNOCOLUMN

R GOPALAKRISHNAN

Reading recent books on business — pharma, financial services, technology firms — it appears that we love to hate business. The truth is that we just cannot do without them. So we mock them, criticise them. Listening to populist politicians, economists, academics and journalists, one could conjure up a vision of the inhabitants of the commercial world as greedy, power-hungry megalomaniacs.

It would not be an incorrect vision, but it would be a seriously partial one. It would be as true and as valid as damning all politicians, bureaucrats, journalists and social sector people through examples of the venal among them. In my last column, I concluded with the statement that there is a difference between a company and an institution, and that, more and more, India needs institutions to realise her potential. Business and entrepreneurship can be soul-elevating, I know that. Atomic physicist, Niels Bohr, said many decades ago, "The opposite of a truth is not a falsehood. It may be yet another truth."

Business makes most of the stuff that we enjoy, it gives the nation jobs and is a synonym for both opportunity and for prosperity. Business deserves a high status in society and should be respected for its virtues, while striving to reduce its vices. Business is human. The frauds by corrupt business are an extension of the propensity of society. Business practitioners stand as much on a pedestal as educationists, doctors, administrators and the defence forces.

Society needs aggressive, entrepreneurial people, they are like the fuel in the car. Second, business energy must be guided with capabilities and infrastructure (education, health, housing and communications being the gear). Third, like brakes and shock absorbers in a car, society needs cushioning from shocks and volatility (regulations, surveillance). The three components of a wholesome society are business, infrastructure and governance.

For the first 35 years after independence till liberalisation, Indian business was regarded by society with huge suspicion. Over the next couple of decades since liberalisation, Indian business spread wings in India as well as globally. For sure, some over-stretched, a few shockingly so. However, this is a phase in larger economic development.

India needs great business institutions, not just companies. Institutions have durability, philosophy, talent and structures, leading to dependable performance. The building of companies as institutions is at a nascent stage in India. Creating and celebrating strong business institutions must become a national priority.

Business is a fabulous force for good in society, conducted by good people with good results for the national good. For example, Unilever and Tata have been highly ethical and responsible companies for over a century, and they have done so with occasional displays of the human frailties that all of us are prone to. In fact, it is those occasional frailties that remind the observer that there are no gods in society — there are some outstanding people, many good people, with a small number of misdirected people.

As some scholars have pointed out, society has three types of people, all operating in the same cauldron. There are "the fearful", who are people with wealth and status but who are afraid of losing them swiftly. Think of zamindars and the princely states from before Independence; think of the wealthy, slow-growing Japanese or European countries, which are anxious that their future generations may be worse off than their own generation. Then, there are "the tormented" who seek to establish themselves as equal members of society — a position that they have failed to achieve because of the historical malpractices of the privileged. Recall the tribal and Dalit communities in India, or the Arabs in the world economic order, as examples of the tormented. Lastly, there are "the aspirants", the people who fight with industriousness and hard work to win a better life for themselves and their descendants. Think of the South Asian, Chinese and Indian economies. Just as the nurturing and support of the south eastern, Chinese and Indian economies have been important for the global economy, business and enterprise, the aspirant class in the Indian economy needs growing and legitimate nurturing in the coming years.

Business and entrepreneurship can do what governments and infrastructures cannot. Business and trade alone can create wealth, growth and jobs. I feel optimistic that this distinctive role for business in the national economy will be supported by society in the that is developing. Business management is a great career for young people — for at least the next 50 years!

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India-UK relations need a reboot

Is Boris Johnson the man to do it?

HASAN SUROOR

Boris Johnson's elevation to Downing Street has evoked conflicting reactions ranging from a mixture of barely-suppressed ridicule and concern in Europe and Russia to hoops of joy in the White House with Donald Trump hailing it as "excellent" news for US-UK relations. Prime Minister Narendra Modi confined himself to a bland tweet saying he looked forward to working with Johnson to "further strengthen India-UK partnership".

Currently, for all the apparent bonhomie, the "partnership" is not exactly flourishing. The two countries are just about muddling through, avoiding any major crisis but showing little sense of urgency to reboot a flagging relationship. Will things look up now that there's a self-proclaimed Indophile (calling himself India's "son-in-law") in-charge at No 10?

At the heart of the problem is a lingering colonial mindset that still informs British foreign policy treating former colonies simply as markets to be mined. The reality that countries like India are now major economic powers in their own right and expect to be treated as equal partners in accordance with their new status has not fully sunk in.

Here's what British Parliament's influential Foreign Affairs Committee said in a report only a few weeks ago: "India's place in the world is changing fast and the UK government needs to adjust its strategy to fit India's enhanced influence and power; the UK cannot afford to be complacent or rely on historical ties."

It warned that Britain risked being left behind in the global race to engage with India and called for an urgent review of its current approach. Is the Johnson administration willing to take up the challenge? It will mean ditching successive Tory governments' policy solely focused on pressuring India into opening up its economy to British businesses while offering little in return.

Johnson's predecessors, David Cameron and Theresa May, talked a good talk describing India-UK ties as one of the "most important relationships of the 21st century" but then went on to take decisions that directly hurt Indian citizens — like retrospective changes to residency rules for high-skilled immigrants that forced many legally settled Indian migrants to return home. Indian protests were ignored. Indians have also been affected by frequent tightening of visa rules for students and intra-company transfers. Indian businesses find visa rules a major hindrance to trading with Britain.

Will Johnson be more accommodating given his much-adumbrated "India connection" (through his estranged wife Marina Wheeler's Indian ancestry), and his personal chemistry with Narendra Modi. He has called him a "firecracker", and a "political phenomenon".

Looking for clues to Johnson's India policy in his rhetorical flourishes and cabinet choices is to ignore the real issues that divide the two countries

His appointment of Priti Patel, a Modi supporter, as home secretary (one of the three great offices of state), and promotion of Alok Sharma and Rishi Sunak to senior positions are seen as a nod towards the BJP/Modi leaning sections of the Indian diaspora.

But looking for clues to Johnson's India policy (to the extent that he might have a cogent policy given his reputed impatience with details) in his rhetorical flourishes and cabinet choices is to ignore the real issues that divide the two countries. The most contentious of these is immigration with India pressing for a preferential visa regime for its citizens on the lines of the one China enjoys to facilitate a "grand" post-Brexit trade deal Britain is seeking.

The May administration's response was a blunt "no". Adding insult to injury, it excluded India from an expanded list of countries from which student visa applicants require "reduced level of documentation". A decision described by Lord Bilimoria, Chancellor of Birmingham University, as "another kick in the teeth for India".

The May government also tried to arm-twist India into taking back thousands of people who it says are Indian citizens living in Britain illegally. But India has questioned the figure. Modi declined to sign an MoU on the issue during his UK visit last year for the Commonwealth conference.

During the Brexit referendum campaign, Johnson promised to open up immigration from Commonwealth countries once free movement of workers from the European Union stopped. Now, however, he's touting an Australian-style points system to be applicable to all applicants with no exemptions for Commonwealth citizens.

Priti Patel, in-charge of immigration, has made clear that only those with "highest skills" would be considered — and that too "only if they have a job offer from an employer registered with the Home Office and if they can speak English".

So, as of now, the prospects of improved India-UK relations don't look too promising. But the threshold is so low that even a slight bounce might seem like a great leap forward. Assuming of course that Johnson himself survives the Brexit turmoil.

The writer is based in London. His new book, Who Killed Liberal Islam, *is published in August*

CHINESE WHISPERS

Gehlot makes a point

While Union Social Justice Minister Thaawar Chand Gehlot is the leader of the House in the Rajya Sabha, Home Minister Amit Shah is the person BJP ministers and floor strategists turn to for guidance whenever he is present. However, on Thursday Gehlot had his opportunity to assert his position. As the Rajya Sabha reconvened after lunch to continue the debate on the National Medical Commission Bill, the Opposition protested that neither Health Minister Harsh Vardhan, nor his deputy Ashwini Kumar Choubey was present in the House. It is customary for at least one minister of a department to be present in the House when it is discussing a Bill moved by the department. Deputy Chairman Harivansh had to adjourn the House for 10 minutes. A message was sent to the two ministers. As the two ministers reached the House nearly out of breath, Gehlot scolded them: "What is this *tamasha*? Neither of you were here and the House was adjourned."

English versus Hindi

Marumalarchi Dravida Munnetra Kazhagam (MDMK) leader and Rajya Sabha Member Vaiko (*pictured*) on Thursday rattled everyone — from Treasury Bench members to the Opposition, including the ally Dravida Munnetra Kazhagam (DMK). As Union Health Minister Harsh Vardhan began his reply on the National Medical Commission Bill in the evening, Vaiko demanded the minister speak in English since the issue was a national one. While the Chair said an interpretation facility was available, MPs of the Bharatiya Janata Party and the Janata Dal (United) tried to shout Vaiko down and demanded the minister speak in Hindi. When Harsh Vardhan, who had switched to English, reverted to Hindi, Vaiko protested. When the Congress' Jairam Ramesh and the DMK's Tirushi Siva tried to mollify him, Vaiko shooed them away. Harsh Vardhan was rattled enough to tell Union Home Minister Amit Shah that he was unsure as to which language he should speak in. The MDMK leader has championed the anti-Hindi movement in Tamil Nadu, and, during slogan shouting in the Rajya Sabha, makes it a point not to add his voice to Hindi slogans.

Tug of war

An upcoming mega convention centre was allotted land in the capital's south-west sub-city of Dwarka last year and construction was expected to be completed by the end of 2019. Now the department executing the project is believed to be lobbying for extra land beyond the allotted perimeter while the Delhi Development Authority (DDA), the city's land-owning agency, is trying hard not to cede ground beyond what it has allotted. The reason, say top DDA officials, is that the land at the location comes at a huge premium. Now the DDA has intensified efforts to auction the patches adjoining the allotted land because it fears that high-profile people involved in the project may use their clout to get what they wanted, said sources.

INSIGHT

Is economics enamoured by taboos?

SOUMYA KANTI GHOSH & SAMIR K JHA

Since the global financial crisis, there have been serious doubts about the theory that the economy functions best with "invisible hand" and it should not be jeopardised through government "intervention". In particular, the discipline (read economics) has somehow rejected the pattern of simple policy prescriptions — that any standard economics textbook imbibes.

At the outset, it can be put on record that just as it is important not to overstate what economics can do, it is critical not to understate it. After all, who would expect to predict global outcomes that depend on the individual actions of about five billion working-age individuals, not to mention the intervention of natural and man-made disasters? While this is true, it is also true that economics provides the essential tools for understanding, and to some degree, shaping those events.

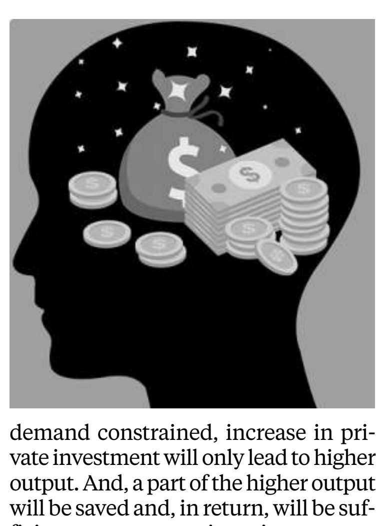
Herein lies the crux of the problem. Such understanding often results in economists limiting their options by reducing their subject to a set of issues that could be modelled. In the process, they are committed to their methods and beliefs that any further movement in the economy, new problems or new topics of interest, are more likely to sit outside their self-defined purview than within. Most of the times, the experts get tempted, therefore, to bang such new problems into shapes to redefine them as per their own predetermined mindset.

Another difficulty that impacts economics as a subject is the fact that the future is inherently uncertain: it cannot be calculated. A lot of human behaviour and some fundamental economic institutions — the desire to hold money, for example — are the result of this fact.

Let us again begin with what happened after the financial crisis. In 2011, when the unemployment rate was 9 per cent, Reinhart and Rogoff had explained that "*current debt trajectories are a risk to long-term growth and stability, with many advanced economies already reaching or exceeding the important marker of 90 per cent of GDP*". However, even eight years down the line, there has been no such tipping point.

However, that did not stop one from arguing that the main threat to the economy was spiralling debt and a resulting spike in interest rates that would lead to the crowding out of private investment and a stagflation crisis of the type experienced in the 1970s. Such warnings miserably failed to come true but it did not stop the misplaced policies of fiscal austerity. If we look at Greece, it is a classic example of secular stagnation. In fact, Greece were to undergo heavy austerity but did not walk down that path and currently yields are at 2 per cent.

Sadly, this crowding out argument has gained enormous precedence in India too. This was clearly evident in a speech by former RBI Deputy Governor Viral Acharya just a few days back. As economists, we have been now following this debate for ages that combined savings of the government is crowding out private sector investment in India. At the same time, we are also witness to the rising noises about slowing down of growth in India due to falling demands. Simple economics suggests these two cannot co-exist. If growth is



demand constrained, increase in private investment will only lead to higher output. And, a part of the higher output will be saved and, in return, will be sufficient to support private investment. Fact is, only when growth is capacity constrained, which apparently is not the case right now in India, any idea of crowding out can be deemed relevant.

Similarly, government borrowings pushing up interest rate is also being pointed out, again mostly by the same set of experts who are making the noises about crowding out. But again, we need to keep in mind the fact that the government borrowings are the additional flow demand, while interest rates are, primarily determined by stock demand and supply of funds. Instances like the above, quite justifiably, force those with not much interest in the debate to conclude (rightfully?) that economics is just a way for the economists and their brethren to rationalise what they already believe.

However, the problem is also in the other direction, that is, misguided fiscal adventurism that had played spoilsport in a country like India. But again, the link between a higher fiscal deficit and inflation or CAD seems to have broken down in recent years.

Importantly, Dr Acharya's paper rightfully argues that market players pick up government debt when private debt is risky; that is exactly what is happening now. However, this cannot be called crowding out as claimed in the paper. Additionally, a jump in government debt results in a decline in private debt, clearly implying we are in a demand constrained economy.

Let us also consider the example of monetary policy. Even after years of quantitative easing (QE) and ultra-low interest rates, advanced economies — particularly the Eurozone — have continued to undershoot even the minimum inflation targets. Thus the long-standing assumptions about downward nominal wage rigidity of the 60s and 70s when organised labour were much stronger is clearly not in vogue now. Employees are willing to work even at a lower wage rate explaining much of the slower growth in labour productivity and a breakdown of the Phillips curve. We are witnessing similar situation in India right now with minimum wage growth and declining productivity.

Another big theoretical assumption, particularly at the micro level, is how strong profit growth will attract new entrants to the market, encouraging more investment. But in recent times, corporate profits and market concentration are both on the rise.

To sum up, knocking economics has become a popular sport, even within the profession. But the world would be much poorer without its contribution to understanding how societies function and without economists' suggestions as to how politicians might improve them. And economists themselves could do wonders by simply incorporating the country-specific factors in their econometric models rather than just applying them in toto.

(The authors thank Prof Sabyasachi Kar for his comments)

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LETTERS

CAG's imputation wrong

This refers to "2 years after roll-out, GST glitches still exist, says CAG report" (July 31). The Comptroller and Auditor General of India (CAG) in his report on GST for 2017-18, which was tabled in the Parliament on Tuesday, pointed out that "the invoice matching system has not kicked-in". The CAG also said, "Invoice matching is a critical requirement that would yield full benefit of this major tax reform". The report's indirect implication that a slowdown in tax collection is because of not matching 100 per cent of invoices, isn't correct. Such an imputation is based on the presumption that evasion is taking place because of not matching. The reason why it is not correct is that an overwhelmingly large percentage of tax payers are not evaders. Government-owned companies which manufacture a very large amount of goods and services do not evade. Large companies having excellent reputation and big service sector companies (such as Tata, Mahindra and Mahindra and Infosys etc) do not evade either.

There is already a huge audit system which conducts auditing with the help of computer system installed in the department. Training from Canadian Government for systemic auditing has also been very effective. Then there is an anti-evasion organisation looking into the evasion aspect of companies prone to it. They depend on collecting intelligence. Matching of raw materials with the final production of goods is conducted by the audit parties of individual manufacturers. So the slowdown in the collection of revenue is not because of evasion. A 100 per cent matching of invoice is never done in any country. They all depend on audit and intelligence gathered by the department concerned. So the CAG could better advice that the whole idea of 100 per cent invoice matching should be given up straightaway. As an ex-insider having knowledge about invoice matching, also having experience derived from other countries, I can definitely say that attempt to match 100 per cent invoices should be given up immediately. It will never succeed. Nobody is willing to say so but that is a fact. Matching should be done only for suspected companies. GST is an amalgamation of central excise, service tax and state VAT. Since for all these three taxes no 100 per cent of matching of invoice was being done, there is no logic in introducing 100 per cent matching for GST.

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HAMBONE

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Fear on D-Street

Tide of bad news has spooked the market

An interest rate cut by the US Federal Reserve, the first since 2008, should have brought cheer to the equity markets. Instead the Indian markets saw huge swings on Thursday and settled lower in line with other Asian bourses. Though the Fed highlighted global growth concerns, it did not signal the beginning of a rate-cut cycle, leading to nervousness. As a result, the BSE Sensex, which had declined 2.1 per cent in intra-day trade, staged a partial recovery, closing the day 1.2 per cent lower. The broader market has been under stress for quite some time now, with the BSE MidCap and SmallCap indices down 26 per cent and 37 per cent, respectively, from their peaks. The Nifty is down about 9 per cent from its peak, but that's because of a handful of large-cap stocks only.

For the Indian market, the global economy is only one of the concerns. It's the local condition that is worrisome with a consistent flow of bad news. Since the IL&FS crisis erupted, non-banking financial companies have been badly affected. The new bankruptcy law, which was supposed to find quick resolutions, is still seeing a majority of the cases dragging on for two years. Jet Airways ended up in insolvency after being unable to find any suitor. Auditors and rating agencies are under the government's scrutiny. Further, the Budget did little for industry, and the super-rich tax has spooked both the C-suite and foreign investors, some of whom will have to bear the additional burden. Other reports such as core sector growth slowing down to a four-year-low, an earlier-than-expected shift to electric vehicles, more powers to customs and excise officers, the amendment to the Right to Information Act, and the prospect of a jail term for violations of corporate social responsibility guidelines are not something that investors were looking for.

Fundamentals, liquidity, and sentiment — three of the key factors that drive stock markets — are all in short supply at present. First-quarter earnings have been disappointing across most sectors because the economy is in the midst of a severe slowdown and consumption is now sputtering. Automobile sales have been falling year-on-year for several months and growth in consumer products is also slowing. With a slump in assets across equities and real estate, the wealth effect has disappeared altogether, as domestic investors are seeing a large fall in their net worth. In such a scenario, they are going to hesitate before investing in equities. Foreign portfolio investors, who brought in net inflows of ₹79,000 crore in the first six months of 2019, pulled out ₹12,000 crore in July. Domestic institutions have been buying for the last three months, but if flows into mutual funds slow, even they would not be able to provide liquidity. Under the current scenario, a 25 bps rate cut in the policy next week from the Reserve Bank of India will not do much for the Indian markets.

Till there are clear signs of an earnings revival, investors may not commit fresh funds. But since the economy is slowing, an earnings revival may not happen fast. At this point, the best that the market can hope for is government action in terms of reforms that will help bring back investor confidence.

Taxation blues

CAG raises valid issues on revenue system inadequacies

Managing government finances in India is becoming increasingly difficult with lower revenue collection and higher spending commitments. If corrective measures are not taken immediately, it would continue to affect economic growth. On the revenue side, the inadequacy of the tax administration, particularly in the context of the goods and services tax (GST), is severely affecting collections. As a recent report of the Comptroller and Auditor General of India (CAG) showed, the GST, which is rightly seen as one of the biggest reforms in recent history, is not working as desired, and some of the implementation issues remain unaddressed. For instance, as the CAG noted, even two years after the roll-out, system-validated input tax credit by invoice matching is still not in place.

Predictably, the inadequacies of the system have had a direct impact on revenue collection. For example, growth in indirect tax collection fell to 5.8 per cent in 2017-18, compared to a growth rate of over 20 per cent in the previous year. The estimated collection was revised lower even for the last fiscal year. Also, the insufficiency of the system has not allowed the appropriate settlement of the integrated GST (IGST). Therefore, instead of lowering GST rates randomly, the GST Council would do well to work on improving the system.

The government's auditor has also highlighted some structural issues in the direct tax administration. While collection and compliance have increased, there is again a need to improve the administration. For instance, the arrears of demand at the end of 2017-18 were in excess of ₹11 trillion, and the tax department thinks that over 98 per cent of this would be difficult to recover. Further, there are plenty of tax cases stuck in different courts. Clearly, there is a case for simplifying tax rules, which will help reduce litigation and improve collection. Hopefully, the task force working on the new direct tax code will recommend ways to reduce litigation.

Therefore, aside from the government's expenditure commitments, subdued revenue collection is affecting the fiscal balance. According to the calculations made by the CAG and presented before the Fifteenth Finance Commission, the fiscal deficit of the Centre in 2017-18 was 5.85 per cent of gross domestic product and not 3.46 per cent as shown by the government. This basically includes borrowing by public sector undertakings to cover government expenditure.

At a broader level, what this means is that the central government, central public sector undertakings, and state governments are using the entire pool of household financial savings. This also explains the overall approach of increasing borrowing from abroad, both at the government and corporate levels, which has its inherent risks.

The government should work on addressing the issues raised by the CAG on the tax administration, especially the GST system, and reassess its expenditure. Though it is correct that rationalising expenditure would be difficult during a slowdown, reservations about Budget numbers and an unsustainable level of public sector borrowing can be more damaging in the medium term. If necessary steps are not taken in time, a course correction would become increasingly more painful.

ILLUSTRATION: BINAY SINHA

Risks to fiscal federalism

To minimise risks, the president may consider seeking response from states and the Centre on the 15th Finance Commission's suggestions

WHAT NEXT

Y V REDDY

The government has proposed to the president to extend the 15th Finance Commission's term by a month, and mandate the panel to suggest ways for allocation of non-lapsable funds for defence and internal security.

Under the terms of reference (ToR) of the Commission, it is proposed to ensure an assured allocation of resources towards defence and internal security imperatives. "The amendment provides that the XV Finance Commission shall also examine whether a separate mechanism for funding of defence and internal security ought to be set up and if so how such a mechanism could be operationalised," an official statement said.

The proposed additional ToR raises a number of questions. First, how does it fit into the overall scheme of fiscal federalism, Budget and financial management, as per our Constitution? The taxes collected by the Union government to be shared with states are distributed between the Centre and states after deducting the collection charges attributable to states. The respective shares are allocated to the consolidated fund of India for the Union government and the consolidated fund of the respective states. Grants-in-aid, as recommended by the Finance Commission, are transferred out of the resources of the Union government which includes the Union government's share of taxes.

Second, the allocation for defence is entirely the responsibility of the Union government. In fact, the 14th Finance Commission (FFC) had recognised the inadequate allocations in the past, as the following extracts will show:

"...Accordingly, its projections have provided for an increase in defence revenue expenditure (including salaries) of 30 per cent in 2016-17 which will incorporate the Pay Commission impact, with a stable growth rate of 20 per cent per annum in the remaining years (Para 6.35)."

"Much of the demand on resources from the Ministry of Defence has been in the nature of capital expenditure, which is beyond the scope of our (FFC) assessment. Recognising that revenue expenditure is critical for defence preparedness and maintenance, we (FFC) have kept the defence revenue expenditure-GDP ratio constant during our projection period, instead of allowing growth to decelerate as was the case in the past. In other words, the rate of defence revenue expenditure has been allowed to increase at the same rate as the GDP, which is substantially higher than the past growth of defence revenue expenditure (Para 6.36)."

Yet, it was the Union government that has been empowered by the Constitution to make an actual allocation to defence. Is it appropriate for a body like Finance Commission to suggest specific allocation for an important sector with implications both for the spirit of Parliamentary control over expenditure allocations and the changing demands of security considerations?

Third, internal security to a substantial extent is the responsibility of state governments since law and order is their responsibility. In fact, when the services of the Central Reserve Police or the Border Security Force are requisitioned by state governments, they have to be paid for out of their Budgets. Further, when their services are utilised by state governments for the purpose of elections exclusively, state governments pay for them. When elections are held simultaneously, such expenses are shared between the Union and states. In brief, both Union and states have respective needs on account of defence and internal security, respectively.

It is hoped that the XV Finance Commission will consider these fundamental issues apart from operational problems and, in any case, it is not obliged to give its recommendations on each and every ToR.

On the process of consultation with states in finalising the ToR of the Finance Commission, the Sarkaria Commission observed: "Any consultation to be meaningful should be adequate." This particular ToR has serious implications for the Union-state relations. Have states been consulted or will they be consulted on the additional ToR?

The Constituent Assembly in its deliberations concluded that the acceptance of the recommendations should not be left only to the Parliamentary approval since the recommendations affect both the Union and state governments. Hence, the Constitution provides for placing of the action taken on every recommendation together with an explanatory memorandum by the president of India before Parliament. The assumption is that the president will exercise his discretion and act not merely as head of the Union, but as head of the Republic of India consisting of the Union and state governments.

In view of recent developments, the practice of keeping the recommendations of the Finance Commission confidential until the decisions are taken and action taken placed before Parliament has implications for the fabric of Indian fiscal federalism. To minimise risks, the president may consider placing the report of the XV Finance Commission in the public domain and also seek specific responses from state governments and the Union government before a final view is taken on the recommendations.

In this connection, it may be useful to quote extracts from the Republic Day speech of a chief minister in 2012:

"There is even larger destruction of the federal structure in fiscal areas. In the name of 'public good' or 'people's rights', more and more funds are making their way to New Delhi. The Finance Commission allocated substantially lesser resources to states keeping the lion's share of funds with the Centre. The Centre has become adept at passing populist schemes but there is no financial support given to states for their execution. Adequate central funds are not an obligation from New Delhi but the right of every state to pursue development."

"These concerns I am sharing today are not only as a chief minister but also as a common citizen of India. Why is it that chief ministers cutting across party lines are expressing serious apprehensions on these repeated attacks on India's federal structure? It is high time the Centre realises that giving to the states what rightfully belongs to them will not weaken the Centre. The states must co-ordinate with the Union government and not remain subservient to it. Co-operative and not coercive federalism must be the norm in our country."

The writer is former governor, Reserve Bank of India

Financial markets: Gatekeepers of money

JIGAR MISTRY

According to the Bank of England, financial markets exist to bring people together so money flows where it is needed the most. Businesses in need of capital should be able to raise it from these markets and repay when no longer in need. In theory, financial markets act as gatekeepers of people's money. But as Yogi Berra famously said: "In theory, there is no difference between theory and practice. In practice, there is."

Of late, the situation in India has been the opposite. Businesses find it difficult to raise capital as debt is funding personal consumption and equity funds invest in businesses with strong cash flows. The genesis of this situation can be traced to banks slowing loan growth after being forced to recognise bad loans, and the meteoric rise and subsequent collapse of non-banking financial companies (NBFCs). The flow of credit to the economy has slowed considerably. The equity market's conundrum is of too much money chasing fewer companies, partly due to change in the mandate and largely because 'nothing succeeds like success'.

It started with the massive surge in private investments in India during 2006-08 when global economic growth was strong. Bad loans (non-performing assets or NPA) at the time were below 3 per cent. However, the 2008 global financial crisis marked the turning point. Growth slowed materially and rendered many projects, which previously looked attractive, unviable. In the absence of effective bankruptcy code, Indian banks resorted to many schemes (JLF, SDR and S4A) to combat rising bad loans, but failed. By 2015, NPA rose over 4 per cent, but the Reserve Bank of India (RBI) still believed that banks were not recognising all bad loans; an asset quality review (AQR) was conducted.

Banks were forced to recognise bad loans and NPA started piling up (it would eventually rise to 11.5 per cent by 2018). Banks curtailed loan growth and focussed on personal loans. Industry, which had about 44 per cent of all bank loans in 2015, received only 9 per cent of incremental loans between 2015 and 2019; personal loans (at 19 per cent of loans in 2015) got a whopping 41 per cent.

Industry's appetite for loans had waned, but banks left even those wanting to invest credit-starved. NBFCs, which were glad to fill the void left by banks got the ammunition when the currency was demonetised (in 2016). This took the shine off of real estate investments and households started moving from physical to financial savings. Mutual funds' non-equity assets under management (AUM) jumped from ₹5.8 trillion in 2015 to ₹12.2 trillion in 2019, a majority of which was invested in NBFC debt (commercial papers and non-convertible debentures). Between 2015 and 2018, mutual funds became the largest suppliers of credit to NBFCs (42 per cent of funding), replacing banks (37 per cent) and insurance firms (21 per cent).

NBFC loans, which were at about 15 per cent of banking loans in 2014, garnered a third of incremental loans between 2015 and 2019. Nevertheless, asset quality was often poor and many NBFCs turned a blind eye to matching asset and liability durations. This and the subsequent IL&FS collapse in September 2018 created a liquidity crunch. Credit markets froze, making it challenging for all NBFCs to raise fresh debt; and a few could not even refinance their loans. Low liquidity has taken a toll on consumer sentiment — sales of discretionary goods (vehicles, white goods) are down and even staples sales are now at threat.

Equity mutual funds did little to counter this. In 2014, about 60 per cent of domestic equity investments (mutual fund and insurance) were in the top-50 companies by market cap. Between 2014 and 2019, three-fourths of incremental money went to these 50 companies, with the other listed companies receiving little investment.

The Securities and Exchange Board of India (Sebi) categorising mutual fund schemes by market cap in 2017 forced them to sell some mid-caps in existing funds. By 2018, provident and pension funds had decided to invest up to 15 per cent in equity, but in the same 50-stock index. Supply of new paper is limited, and it is quickly becoming a case of too much money chasing a few stocks. The Nifty50 index is down about 5 per cent from its all-time high, but more than 80 per cent of stocks are down more than 20 per cent and 50 per cent stocks have halved. A stock that has halved will face a tough time raising equity.

But it's not all bad — India now has a bankruptcy code and resolutions have started. A few battered NBFCs could end up with new managements or with stronger partners, thereby stemming the rot. Nevertheless, the cost of capital in India is too high. Despite policy rates falling 75 bps, the borrowing cost has not come off. The small savings rate still yields over 7.5 per cent; it needs to come down. Also, Sebi should allow mutual funds to invest a larger proportion of their funds across market caps and provident funds must consider investing in a broader index.

If financial markets fail to help businesses raise money, economic growth will suffer. Participants in financial markets are the gatekeepers of people's money; a more frequent reminder will help.

The writer is director at Buoyant Capital

Anatomy of a flood

BOOK REVIEW

UTTARAN DAS GUPTA

On December 1, 2015, a record downpour of 490 mm — often described as "once in a 100-year" rainfall — inundated Chennai, killing hundreds and displacing thousands of its citizens. It also exposed how Indian cities are ill-prepared for such extreme weather events, which are likely to become more and more common as the climate change situation worsens. In *Rivers Remember*, Ms Ge — a writer, editor and citizen of Chennai — investigates what caused the calamity in her hometown and arrives at the conclusion that more than extreme weather it was administrative apathy that worsened the situation. This is not a fact of which we are unaware but are often reluctant to acknowledge.

In the Prologue of the book, "How On Earth Did This Happen to Us" (the title is acknowledged to be inspired by Haruki Murakami's Underground: *The Tokyo Gas Attack and the Japanese Psyche*), Ms Ge writes: "My conversations and investigations uncovered that the floods of 2015 in Chennai were a manmade disaster; that the Tamil Nadu government had played an undeniable role in drowning clueless citizens without any warning... it had also played an active role in sabotaging the city's water bodies."

As she demonstrates through her research, the administration had over the decades mismanaged the uncontrolled expansion of the city, permitting construction on lakes and riverbeds, making people living there vulnerable to such a weather event. "If you live in urban India and find your home and your city sinking, it's probably because of the mismanagement of water bodies," she writes, "because rivers remember". They remember their old homes and courses, even if people who have encroached upon them forget all about it. This forgetfulness and apathy on the part of the citizens expose them to the vagaries and fury of nature at times of such calamity.

The floods in Chennai were widely reported on in the national and international media, but Ms Ge abandons the critical distance expected from traditional journalism and plunges into a personal narrative — of her home, her family, and her city. In doing so, there a recognition of privilege and vulnerability: "There's a creeping sense of discomfort in the air, which is new to those of us cushioned till now by the privileges of the salaried class." On the day of the flood, her parents' home — in which she and her brother grew up — is inundated. After the flood waters withdraw, when her family returns, they find their home washed away: "...it looks like a war was fought in there. A battle with the Adyar River... What no one tells you about floods... is that it is not water that comes into your home... what flows into your home when it floods is sewage... Mostly human waste...."

Ms Ge seems to have conducted an endless number of interviews and she painstakingly reproduces them in her book. This is a powerful narrative technique, pitchforking the reader into the calamity through its recollection

Her family is, of course, not the only one that's affected. Ms Ge seems to have conducted an endless number of interviews and she painstakingly reproduces them in her book. This is a powerful narrative technique, pitchforking the reader into the calamity through its recollection. Why she chooses some narratives over others is not always clear. Some are obvious, such as that of engineer and volunteer Muhammed Yunus, who gets together a contingent of boatmen to rescue 800-odd people stuck in Urappakkam or of Dr Bala, a gynaecologist whose private hospital and pregnant patients were marooned in the flood. The inclusion of some others, such as that of Anantha Narayanan, a resident of Keezhkattalai, and his family, seem a little random. Having said that, it must be acknowledged that every narrative — of the lucky survivors and those not so lucky — is acutely poignant.

Another subject that the book explores is the role played by journalism in reporting the floods — and how it was prevented from doing its job. She writes in detail about how the overtly centralised government of former chief minister J Jayalalithaa prevented the free flow of information, not only about the floods, but also about the incumbent's failing health. "Many newspapers were sent criminal notices for just speculating about Jayalalithaa's health... over 200 such cases were filed by the AIADMK between 2011 and 2016." The same lack of transparency plagued information about the floods. "I filed a query under the RTI Act to find out the exact number of casualties due to the Chennai floods... The reply (was)... 38 persons. ...Thirty-eight is the official number... Not 512 as the newspapers had reported. Not 269 as the home minister had claimed." In a note of despair, she writes: "I, unfortunately, failed... to find out just which of these numbers was real."

Amartya Sen has asserted in his writings that famines cannot occur in countries with a free press. After reading Ms Ge book, we can also assert that floods cannot occur in a country with a free press — and the absence of one makes us vulnerable.

RIVERS REMEMBER: #Chennai Rains and the Shocking Truth of a Manmade Flood
Krupa Ge
Context (Westland); ₹499; 218 pages