A counterproductive idea

In retrospect, the government's move to get more RBI funds for itself has paid it no dividend

RAISINA HILL

A K BHATTACHARYA

What the central board of the Reserve Bank of India (RBI) decided last Monday, based on the recommendations of the Bimal Jalan committee, was disappointing for those in the finance ministry, who had hoped to secure for the exchequer a little more extra money from the central bank's reserves.

But what has not been appreciated so far is that a bigger disappointment awaits the government when it gets ready to present the next Budget, just five months later in February 2020. Along with that will arise a politically embarrassing question on the Modi government's governance style. If so little was secured by way of extra capital from the RBI after months of deliberations, growing doubts on the government's commitment to provide autonomy for the central bank and the souring of relations with an RBI governor, who eventually quit, was the entire exercise counterproductive?

The Jalan committee was set up in December 2018 to suggest a formula for determining the prudent level of reserves that the RBI must keep with itself as part of its economic capital framework. The government had hoped that the new formula would pave the way for the RBI board to transfer more money to the central exchequer to help finance its expenditure programme, which was starved of adequate resources.

But the recommendations of the Jalan committee did not give much leeway to the government for taking advantage of the RBI reserves. It's true that the total transfer from the RBI to the Centre is estimated at ₹1.76 trillion in the current year. Of this, ₹1.23 trillion arose out of the RBI's net income, thanks largely to the ₹3 trillion of open market operations it conducted during the July-June period of 2018-19.

The remaining ₹53,000 crore was transferred following the adoption of the new formula to keep the RBI's contingency reserve at 5.5 per cent of its balance sheet, which was the lower end of the recommended formula. The Jalan committee had recommended a range of 5.5 to 6.5 per cent of the balance sheet for deciding on the contingency reserve level. Before enforcing the 5.5 per cent formula, the RBI's contingency reserve was about 6.8 per cent of its balance sheet.

The government's additional financial bonanza, thus, was only ₹58,000 crore. That is because the government had already taken credit for ₹28,000 crore of surplus by way of interim dividend from the RBI in its Budget for 2018-19. An estimated ₹90,000 crore had already been provided for in its 2019-20 Budget as dividend from the RBI.

So, the actual extra money with the government after this elaborate, and controversial, exercise is only about 0.3 per cent of gross domestic product (GDP). This is neither adequate for meeting the demands for higher expenditure, nor even the revenue shortfall that is being feared.

Worse, the expected income from the RBI during 2020-21 may be significantly less than what was transferred in 2019-20. There will be no scope for any further gain from the contingency reserve of the RBI, since the lowest level of the suggested benchmark has already been reached. Indeed, with the RBI balance sheet expected to grow by 7 to 10 per cent next year, there would be need to transfer from its income more money to the contingency reserve to keep it at 5.5 per cent of the balance sheet. The currency and gold revaluation reserves, estimated at ₹6.6 trillion, cannot be touched either as the Jalan committee has categorically stated that this money cannot be redistributed to either maintain other funds or meet dividend requirements. A significant fall in the government's income from the RBI next year will exert more pressure on its finances.

The question that is likely to arise then is whether the government imprudently wasted so much of its goodwill and even political capital to secure higher transfer from the central bank's reserves. Its demand for more capital transfer from the RBI was first raised in the Economic Survey, presented by the government in February 2016. The argument for transferring RBI's "excess" capital to the government to help it recapitalise banks and extinguish government debt was raised again in the Economic Survey presented a year later in February 2017. This issue was raised again by finance ministry bureaucrats in the subsequent year, even as the then RBI Governor Urjit Patel made his reservations about such a move known to the government.

Finally, a government advice to the RBI in October 2018, under Section 7 of the RBI Act, seeking consultations on its economic capital framework led to the formation of the Jalan committee. The RBI board decided to form this committee at its November 19, 2018, meeting. Urjit Patel resigned on December 11. The Jalan committee's deliberations were stormy on occasions, with the government representative on it once refusing to sign the report to show his disagreement with its recommendations. Once the government nominee was changed following his transfer to a different ministry, the committee quickly completed its report and submitted that to the RBI, whose board adopted it on August 26.

But the end result could not have been very satisfying for the government. The entire exercise over deciding afresh the economic capital framework for the RBI and the resignation of Patel worsened the already fraught relationship between the country's central bank and the government. And now the disappointment will be more since all those moves have not even helped it achieve its primary goal of substantially increasing the funds transfer from the RBI to the central exchequer.

Jalanomics: No rain, just a drizzle

Even that's enough for the parched earth of government finance

BANKER'S TRUST

TAMAL BANDYOPADHYAY

The Reserve Bank of India (RBI) modelled its official emblem on the double *mohur* of the East India Company. The lion under a palm tree on the logo later gave way to a tiger to represent India better.

Last week, after the Indian central bank announced transferring ₹1.76 trillion to the government (of this, ₹28,000 crore was given as interim dividend in March 2019), a meme was doing the rounds in social media, taking the flesh out of the large feline of forests, making it a skeleton. The record money transfer includes ₹1.23 trillion surplus of the year (RBI follows July-June financial year) and another ₹52,637 crore one-time transfer, in accordance with the recommendations of the six-member panel, headed by former RBI governor Bimal Jalan, set up in December 2018 to look into the so-called economic capital of the Indian central bank.

There have been many reports on how the central bank has been raided, looted, and even turned into an LIC for the government. (Life Insurance Corporation of India or LIC typically comes to the rescue of troubled financial institutions; the latest example being IDBI Bank Ltd).

The noise started building up even before the panel was formed when a finance ministry bureaucrat wanted as much as ₹3.6 trillion from the RBI. As member of the committee, he had raised his voice of dissent but had to leave the panel because of a reshuffle in the bureaucracy after the Union Budget. In search of consensus, the panel missed the deadline for submitting the report. The contentious subject also scalped a governor and led to an early exit of a deputy governor.

Has the panel played the role of a government agent and milked the central bank's balance sheet dry to help government spend and bring down the fiscal deficit?

For the fiscal year ending July 2019, the RBI's assets are to the tune of ₹41 trillion. Of this, investments in domestic securities are ₹9.9 trillion and foreign currency and gold ₹29.5 trillion. The income from domestic sources rose from ₹509 billion to ₹1.18 trillion because of the increase in interest income. Following a change in the accounting norms, the income from foreign currency assets too rose. The combination led to higher transfer of money to the government.

That's an annual ritual. Most media reports had speculated on a transfer of extra money in a staggered way over the next few years. In reality, there is a one-time transfer of ₹52,637 crore to the government's coffers. How has this been generated?

Unlike a commercial bank, a central bank does not need to adhere to a capital adequacy ratio. The so-called economic capital (or reserves) of the Indian central bank has four components — the paid-up capital (₹5 crore since its inception); asset development fund (₹228.75 billion), used for investing in various subsidiaries of the RBI; contingency fund (close to ₹2 trillion), equivalent to investment fluctuation reserves of commercial banks for taking care of any notional losses of its assets; and the revaluation reserves (₹7.3 trillion).

The revaluation reserves, roughly 79 per cent of the total economic capital of the RBI, is something intangible which can't be felt and touched. The foreign exchange assets are marked to market every week to show their current market value as opposed to the cost at which they were bought while gold assets are marked to market every month. The gains (or losses) create the revaluation reserves.

There were apprehensions that the Jalan panel will swoop down on the revaluation reserves. It has not done that. In fact, it has recommended a one-way transfer — if the value goes down, it needs to be replenished but gains cannot be booked. It has also fixed a band for the contingency reserve — 5.5-6.5 per cent. The RBI board has decided to keep it at 5.5 per cent. This is lower than 6.8 per cent, the last year's level, but definitely not something that amounts to looting of the RBI.

Till now, every year the RBI has been transferring part of its surpluses to the contingency reserves. Following a 1997 panel's recommendation, it was 12 per cent; another panel in 2004 recommended a higher flow at 18 per cent but that was not accepted. Finally, in 2013, yet another panel, headed by noted chartered accountant and long-time director on the RBI board YH Malegam recommended transfer of an "adequate amount of its profit" to the contingency reserves, without specifying it in percentage term. The Jalan panel has shifted the focus from a percentage of profits to assets, and rightly so.

It has also recommended a 20-24.5 per cent band for the size of the economic capital; the board has kept it at 23.3 per cent this time. This is lower than the level of last year, around 27 per cent.

Besides not touching the revaluation reserves, the panel has put in place a framework and asked for periodic evaluation of this every five years. This means at least for the next five years the quantum of money that will go the government's coffers won't depend on the whims and fancy of any bureaucrat or minister. It has also expressed reservations about the RBI giving interim dividend to the government and is in favour of shifting its financial year from July-June to April-March, in sync with the government's accounting year.

This is Jalanomics at its best. It has not poured; or, even rained for the government. It just drizzled but even that's good for a perched earth of government finance.

POSTSCRIPT

A caveat: Can part of the revaluation reserves be transferred to the profit and loss account by actual transactions? The change in the methodology of calculating income from foreign exchange reserves — weighted average cost of reserves — will entail profit-booking on every sale of foreign exchange. In some sense, this is akin to a transfer out of the revaluation reserves to income. I am told this had been recommended earlier by the Malegam panel and the Jalan panel merely endorsed it. The paradox is that if the rupee weakens during any year, the RBI will end up booking profits while selling dollars to defend the currency.

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CHINESE WHISPERS

Tharoor-bashing continues

Congress Member of Parliament from Thiruvananthapuram Shashi Tharoor (*pictured*) continues to face flak from his party colleagues for his alleged "Modi praise". Days after the Kerala Pradesh Congress Committee directed party leaders to refrain from making public statements after a controversy broke out over Tharoor's statement that Prime Minister Narendra Modi should be praised for the "right things", K Muraleedharan, Kerala politician and son of the late Congress leader K Karunakaran, made a veiled attack on the three-time MP. It was not "Oxford English" but the "anti-Modi" stand that had helped the party-led front win the Thiruvananthapuram seat, he said. Continuing his tirade, he said, Congress leader and former MP, the late A Charles, who did not know "Oxford English", had won the same Lok Sabha seat three times. Muraleedharan had earlier said those who wanted to praise Modi should join the Bharatiya Janata Party.

Package deal

Is former Kolkata mayor Sovan Chatterjee already thinking of quitting the Bharatiya Janata Party (BJP)? Seems like it, if one were to go by what his close associate Baishakhi Banerjee had been telling journalists in Kolkata. At a gathering over the weekend, she claimed that Chatterjee was being "regularly humiliated and insulted without any reason" by his new party. She added that Chatterjee had taken a sabbatical from active politics and had agreed to join the BJP on her insistence. "We have expressed our desire to leave the party," she said. "If needed, we would send our resignation to the party leadership." Reacting to her allegations, West Bengal BJP president Dilip Ghosh said he would most definitely look into the matter.

Say cheese!

If things go according to plan, Madhya Pradesh will soon become the first state in the country to put together a happiness index. Madhya Pradesh Institute of Happiness CEO Akhilesh Argal said his institute was giving the final touches to the questionnaire for the upcoming government survey to measure happiness. The survey will be launched in November and is expected to be completed by the end of the financial year. IIT-Kharagpur's Rekhi Centre of Excellence for the Science of Happiness is the state's knowledge partner for the project. About 15,000 people from various villages, towns and cities in the state are expected to be contacted and their views on a wide range of topics — such as lifestyle, income, education, health, safety, interpersonal relationships, attachment to environment, etc — would be taken into account to put together the index.

AS I SEE IT

A constitutional legerdemain?

The government might have transgressed the letter and spirit of the Constitution with its decision regarding Article 370 and the division of J&K along with its demotion to Union Territory status

KARAN THAPAR

Now that the Supreme Court has referred the government's decision regarding Article 370 and the division of Jammu and Kashmir along with its demotion to Union Territory status to a five-judge Constitution Bench, which will start its hearings in October, a sharp light will be focussed on the constitutionality of these measures. In a comprehensive and very insightful interview for *The Wire*, Prof. Faizan Mustafa, vice-chancellor of the Nalsar University of Law, has presented a convincing case for arguing the government has indulged in constitutional legerdemain. It's worth examining his reasoning closely.

First, Article 370. It hasn't been abrogated. Although that verb is widely used, it only reflects ignorance of what the government has actually done. Instead, the provisions of Article 370 have been used to de-operationalise the article. This was, essentially, a three-stage process involving two separate re-interpretations of the constitution.

First, Clause 1 (d) of Article 370 empowers the President to apply "other provisions" of the Constitution to Jammu and Kashmir with the "exceptions and modifications" he may specify. This was used to add a clause to Article 367, which basically defines the terminology used in the Constitution. As a result, the phrase Constituent Assembly of Jammu and Kashmir was re-interpreted to mean the Legislative Assembly of the state. Then, this re-interpretation was applied back to Article 370. Consequently, it changed the meaning of Clause 3, which originally only permitted the de-operationalisation of the Article on the recommendation of the Constituent Assembly. Now that was possible on the recommendation of the state legislature.

Having thus altered the meaning of Article 370, the government took a third critical step. It used the fact that under President's rule the powers of a state legislature are transferred to Parliament to further argue that the required recommendation of the Jammu and Kashmir legislature can now be exercised by Parliament. So, Parliament on behalf of the State Legislature, recommended that Article 370 be de-operationalised and the government accepted it.

Now, in his interview, Prof. Mustafa not only explains in detail the intricate details of this constitutional trickery but points out why the Supreme Court could strike it down. First, Clause 1 (d) of Article 370 applies to "other provisions" of the Constitution. Can it therefore be legitimately used to modify Article 370 itself? Second, Kesavananda Bharati in 1973 imposed a statute of limitations on Parliament's capacity to amend the Constitution. Surely, there are similar implied limits to what Article 370 can do to amend and modify the Constitution? If the first question suggests the government has breached the letter of the Constitution, the second accuses it of transgressing its spirit.

Let's now come to the way the government has divided the state and demoted it to Union Territory status. Article 3 of the Constitution gives the government the power to do this provided the Bill for this purpose has first been referred by the President "to the legislature of that state for expressing its views thereon". The government claims that because under President's rule, the powers of the Jammu and Kashmir Assembly have been transferred to Parliament, this requirement was fulfilled on the Assembly's behalf by Parliament. This is the precise point Prof. Mustafa questions.

He accepts that the powers of an Assembly can be transferred to Parliament but asks if the expression of its views can be similarly transferred? He believes not. He insists there is a distinct difference between powers and the expression of an opinion. The latter can only be voiced by the Assembly, which is the institution that represents the people of the state.

So, if the way Article 370 has been de-operationalised was, arguably, the first sleight of hand, the manner in which the state has been divided and demoted is, possibly, the second. Both these issues will be examined by the Supreme Court's Constitution Bench and many believe that this will be as fundamental a test of its integrity and commitment to the Constitution as the ADM Jabalpur case of the Emergency years.

Let me mention one other point made by Prof. Mustafa. Since Article 370 has only been de-operationalised — and not abrogated — it remains a part of the Constitution. This means a future government, if it has the majority and the will, can reverse what this government has done. Whilst maintaining this is a theoretical possibility, Prof. Mustafa believes it's unlikely any future government will thus act. But now the possibility of undoing what the government has done will first be exercised by the Supreme Court. We don't know what conclusion it will come to but it's possible it might agree with Prof. Mustafa's reasoning and declare the government's action unconstitutional.

(If you want to hear Prof. Mustafa's arguments in full go to https://thewire.in/video/watch-sc-can-void-move-since-by-passing-assembly-was-not-in-spirit-of-constitution.)

LETTERS

Give total support

This refers to "Consumer demand grows 3.14%, lowest in 17 quarters" (August 30). In this context, the projected growth in consumer demand of private final consumption expenditure (PFCE) of 3.14 per cent is more due to demand for fast moving consumer goods (FMCG) — basically essentials — than due to developmental growth. The index of industrial production (IIP) showing a meagre percentage of increase substantiates this. Job losses and inflation are the basic causes of a fall in demand. However, raising conjectures on the actual percentage of growth is only self-deceit and cannot offer meaningful solutions.

Further, as rightly pointed out, consumer sentiment governs market demand for commodities. In the prevailing scenario, the consumer hesitates to spend for anything other than essentials. They face liquidity problems, thus lowering demand leads to economic paralysis. However, merely blaming endogenous and exogenous factors does not address the problem and active policy measures to revive economic activity should be undertaken. Investment should be given greater importance for economic revival as non-utilisation of the spending power will only lead to further economic deterioration. Such a situation is to be addressed at the grassroot level by increasing supply of commodities through promotion of small and medium industry with an initial capital support by the government. Capital support should not be merely monetary but also infrastructural.

C Gopinath Nair Kochi

Need of the hour

The process of consolidation of public sector banks had received a shot in arm with Union Finance Minister Nirmala Sitharaman announcing big and bold steps aimed at redrawing the financial landscape of the country. With the mega merger plan, the number of state-owned banks would be reduced to a dozen. While consolidation offers the promise of economies of scale, the question whether the creation of bigger banks will lead to the emergence of stronger entities will remain, given the challenges in terms of manpower rationalisation, cultural fit and opposition from bank unions. The success of the process of consolidation of state-owned banks depends on the enhanced capability of the Reserve Bank of India to exercise its regulatory oversight and ensuring financial stability. The implementation of long overdue banking reforms with a thrust on infusing transparency and accountability in the functioning of the boards of state-owned banks is the need of the hour.

M Jeyaram Madurai

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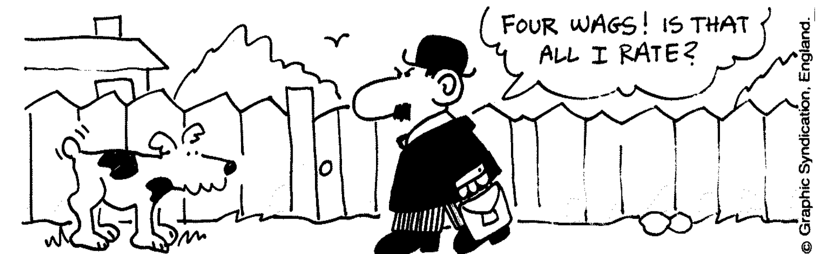
HAMBONE



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The growth collapse

Global factors do not fully explain the slowdown

There was a near consensus on the direction, but the magnitude of the deceleration in growth surprised most analysts. The Indian economy in the first quarter of the current fiscal year grew at 5 per cent, compared to 5.8 per cent in the previous quarter and 8 per cent in the same quarter last year. While growth in the manufacturing sector slowed to a dismal 0.6 per cent, expansion in agriculture slipped to 2 per cent, compared to 5.1 per cent last year.

The latest data should worry Indian policymakers because it is now absolutely clear that problems in the economy are much deeper than they were willing to accept. Nominal growth during the quarter collapsed to a 17-year low of 8 per cent. This will not only affect revenues for the corporate sector and their ability to repay debt but will also put government finances in serious trouble. The Union Budget has assumed a nominal growth rate of 11 per cent.

Growth has slowed due to a variety of reasons. For instance, as the government has also argued, the global economy is slowing and uncertainty has risen because of US-China trade tensions. However, this is a specious argument because global factors do not fully explain the extent of the slowdown and should not be used to cover India's internal weakness. For example, China, which is at the centre of the ongoing trade war with the US, grew at 6.2 per cent in the June quarter. It is difficult to argue that India is getting affected by the trade war more than China. Further, Vietnam clocked a 10-year-high growth rate of 7.1 per cent in 2018, according to the International Monetary Fund. Reports suggest that it is now facing a shortage of labour. Businesses moving out of China are looking to set up plants in Vietnam. Similarly, Bangladesh, after growing at about 8 per cent in FY18, is expected to grow at well above 7 per cent. Moreover, global financial conditions are benign and crude oil prices are within India's comfort zone.

However, the high-frequency data suggests that a rebound is not imminent. The government's reluctance to accept the problem has also worsened the situation. In fact, instead of improving the ease of doing business, the July Budget ended up dampening business and investor confidence. To be sure, the government has taken some positive decisions in recent weeks, but it would not be enough to revive economic activity to the level desired. So, there will now be a clamour for fiscal stimulus. Clearly, the government does not have the room to increase expenditure. On the contrary, the slowdown will itself put enormous pressure on government finances. Since inflation is expected to remain low, there is scope for monetary accommodation. But transmission has been an issue, and monetary action in India works with a lag of two to three quarters.

Policymakers would be well advised to not solely depend on monetary policy for revival. The nature of the slowdown suggests that problems are not cyclical alone. Granted that growth will stabilise once issues in the financial sector are addressed. But this would not be enough. India needs wider structural reforms in practically every aspect of doing business to compete in a rapidly changing global environment. In the absence of structural reforms, as the history shows, India will only see bouts of relatively high growth, but will not be able to sustain it.

Free the banks

Mergers are cosmetic without real governance reform

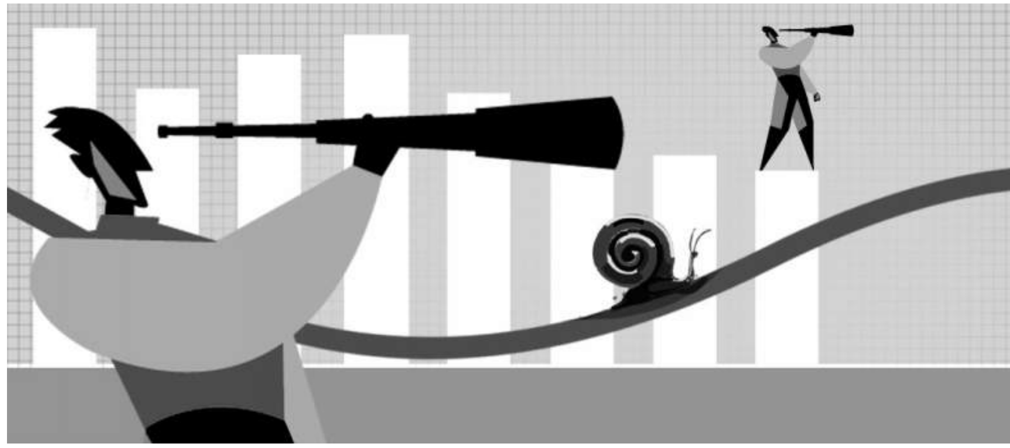
Union Finance Minister Nirmala Sitharaman on Friday announced that the government planned to merge 10 public sector banks (PSBs) into four. The government hopes thereby that the state-controlled section of the banking sector, which has long been under pressure due to stressed balance sheets, will find itself strengthened if these banks pool their resources. Combined with the front-loaded recapitalisation of PSBs announced earlier, the government clearly hopes that larger banks will recover some of their risk appetite and step up lending to the productive sectors of the economy — which would, in turn, spark an economic revival. The plan for PSBs was, in fact, announced just a few hours before the scale of the growth slowdown was revealed by the National Statistical Office.

Certainly, the logic stated by the government does not go far enough. What is additionally problematic is that the history of merging state-run corporate entities in response to government diktat in India is not particularly encouraging, across sectors. Operational efficiency from such mergers of public-sector units is often elusive, especially if layoffs and other cost savings are minimised. In this sector, in particular, the question is one of independence, autonomy, and the credibility of the public-sector banks' boards. When the government takes a decision like this, it is harder to make the claim that the bank boards are doing their job independently. Ideally, decisions to merge should be made by bank boards, fulfilling their stated responsibilities.

It is ironic that the government, in response to criticism of PSBs and their operations, has said that it seeks to further empower the boards. Confidence about such empowerment, or even the genuineness of the government's intent to eventually empower the boards, is unlikely to survive such major changes being essentially dictated to bank boards by bureaucrats in New Delhi.

The government's objective in merging the PSBs is praiseworthy, and deeper balance sheets might well help in the short run. However, the systemic problems within the state-controlled banking sector must be addressed if any revival of credit is to be of the quality that would support sustained growth. The focus should be on real governance reforms. Road maps for such reform are widely available, including from the P J Nayak committee on banking reforms. The committee had made many important recommendations, such as legal changes to allow for reducing government stake below 50 per cent in PSBs. Even before such stake sales and the eventual dissolution of government ownership, at the very least a bank-holding company must be set up. The committee recommended that the bank-holding company should be transferred the government's shares in the PSBs and, thus, it could serve as an institutional firewall between the government and the bank managements. This recommendation has, however, been put on the back burner. The Banks Board Bureau, set up as an interim step, was soon seen to be ineffective. In the absence of moves towards genuine reforms in a large section of the Indian banking sector controlled by the government, all other measures will be seen as cosmetic. And an inefficient banking system would continue to impede an efficient allocation of capital.

ILLUSTRATION BY AJAY MOHANTY



Fixing the growth puzzle

Cyclical responses won't fix the structural constraints, and structural reforms don't address a cyclical slowdown

GDP growth slowed to a six-year-low of 5 per cent during the April-June quarter, which is weak, no matter how it is sliced or diced. Private consumption demand was hit hard, investment remains lacklustre, and export growth has slowed. This raises two issues: Reasons behind the slowdown and the solutions.

Is it cyclical or structural?

The slowdown is partly cyclical and partly structural. The cyclical slowdown is only a year old, but the structural (trend) slowdown has been ongoing for five-ten years.

Two cyclical factors have contributed to the growth moderation over the last year: Shadow banking stress and weaker global demand.

For shadow banks, access to funding has not yet fully recovered and, while funding costs have declined for most, there is still credit risk differentiation. This has hurt sectors that are dependent upon shadow banks, such as small and medium enterprises, consumer lending, and real-estate developers.

Similarly, the synchronised global growth slowdown has spilled into the domestic economy via export and manufacturing channels.

However, there is also a structural element to the current downcycle. India's investment-to-GDP ratio has been declining since 2012, and productivity growth has stalled. This suggests that the trend growth rate has declined.

Among other factors, the peaking of the financial (credit and housing) cycle and corporate balance sheet deleveraging cycle have resulted in lower investment demand.

In addition to cyclical and structural forces, the timing of some of the policy changes, which are intended to benefit over time, have made the process of deleveraging tougher. For instance, the goods and services tax, demonetisation, measures to curb corruption, and the move to flexible inflation targeting led to a combination of lower inflation, higher real rates, and lower nominal growth. As nominal expectations are reset lower, the transition is tougher for debtors.

The cyclical fix

Cyclical slowdown calls for a counter-cyclical policy response. Weak GDP growth suggests the negative output gap is larger than anticipated, which should open more space for monetary policy easing, given low inflation.

On the fiscal front, if budgeted targets are met, then the fiscal impulse to growth will be negative, even after accounting for off-balance sheet borrowing, due to the weak state of the business cycle.

SONAL VARMA

This does not mean that a fiscal stimulus should be announced because increased borrowing would raise the risk-free interest rate and partly negate policy transmission. At this stage, the government should frontload its spending, because that would be an ideal response to current weakness in private demand. If the slowdown persists or deepens, only then should a counter-cyclical fiscal stimulus be considered.

Liquidity is most important. The shadow banking crisis has increased financial-stability risks. While positive liquidity does not directly address the confidence issue, it is still necessary to ensure the financial system does not choke.

Excess liquidity will slowly lead to a chase for higher returns and will narrow spreads across the risk spectrum. Faster transmission via the banking system requires both positive liquidity and healthier balance sheets. Until financial stability and growth risks are clearly averted, the central bank should provide a guidance that liquidity will remain in surplus.

The good news is that the shift to surplus liquidity is finally aiding faster policy transmission and the cumulative effect of monetary policy easing should aid a recovery in the growth rate *cycle* in coming quarters, unless the US economy falls into recession.

The structural fix

Lower interest cost can help the leveraged corporate sector, but monetary policy is not the answer to reversing a structural "trend" slowdown.

To reverse investment slowdown and attain higher sustainable growth, a key question is: What should be India's growth model?

India, unlike the Asian tigers, cannot rely on exports alone, given deglobalisation trends. Instead, a multi-pronged strategy is necessary, including: 1) fast-tracking infrastructure investments; 2) raising export market share via competitiveness; 3) attracting global value chains that are shifting away from China; 4) prioritising domestic production over imports; and 5) leveraging sectoral strengths.

Six priorities will help achieve these objectives

First, law and order lies at the core of a rule-based society. Encroachment in cities, delays in land acquisition, cost overruns, etc are common complaints. Judicial reforms and ensuring timely contract enforcement are important. Compliance with the law should be made easier, while non-compliance should be tougher.

Second, financial-sector reforms need a push. We need to strengthen existing entities (shadow banks and public-sector banks), but we also need more instruments, more players, and deeper capital markets.

Third, to boost productivity and raise efficiency, bureaucratic reforms are a starting point. Tax simplification (direct tax code) and continuing down the path of factor-market reforms are medium-term necessities.

Fourth, to address funding constraints and dearth of risk capital, asset monetisation and privatisation are an option. Reorienting general government spending from consumption to capex is another. The domestic savings gap and the global environment (of low rates and low growth) all argue for tapping foreign capital both for unlocking stuck projects and greenfield investments.

Fifth, the business model of small and medium enterprises has to be scaled up by addressing the constraints that lead to threshold effects (smaller size). Leveraging technology to link small entrepreneurs to the final consumer is an option.

Finally, many sectors in India have huge potential and there should be a bottom-up strategy to maximise their potential. These include agriculture, food processing, tourism, small cars, motor cycles, medical services, gems and jewellery, and clinical research.

To summarise

India's growth slowdown is both cyclical and structural. Cyclical responses are already in place. They will lift the cycle and create the space to implement structural reforms. However, cyclical responses cannot fix the structural constraints. Let us not mix the two.

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Big bank theory

Financial markets often use a term "big-bang reforms", something that they want the Indian government to unleash. There is no clear definition of this term but we can draw upon Potter Stewart's (Associate Justice of the US Supreme Court) test of obscenity: "I know it when I see it." Last Friday, Finance Minister Nirmala Sitharaman announced another round of mergers of select public sector banks (PSBs). Many people feel this is what big-bang reforms look like, wistfully recalling the heady days of 1991. Does it? The test for big-bang reforms is two-fold: Something that is immediately and very positively impactful and irreversible.

In 1991, within a few months of coming to power, P V Narasimha Rao abolished a silly law called the Monopolies and Restrictive Trade Practices Act, which only put hurdles on production - when India was perpetually short of everything. That was "big-bang reform" because it freed the genie of entrepreneurship that was bottled up for decades. I am sure there will be some benefits in these mergers too, but merging a bunch of weak PSBs to make them bigger fails the test of big-bang reforms. M G Bhide, a thoughtful, retired chairman of Bank of India, says banks will save on cost and have money to invest in technology. Also, with fewer banks, the scope for the number of political appointees reduces. Another ex-chairman of a PSB is less charitable. "If you combine a small mess, you will only get a bigger mess," says he.

IRRATIONAL CHOICE
DEBASHIS BASU

Poor track record

We will have to wait and see what happens. What is inescapable, though, is the track record of this government; it has given us enough reason to be sceptical about another experiment with merging PSBs. The government has been struggling to fix PSBs for over four years through incremental reforms. There is minimal progress and plenty of evidence that politicians don't get it — they are living in a world of their own.

Gyan Sangam: In January 2015, Prime Minister Narendra Modi went into a huddle with PSB chiefs to draw up an action plan for banking reforms — a two-day, top-level retreat, branded *Gyan Sangam* and attended by the finance minister, RBI governor, minister of state for finance Jayant Sinha, and secretaries in the finance ministry. The prime minister wanted to "achieve a broad consensus on what has gone wrong and what should be done both by banks as well as by the government to improve and consolidate the position of PSBs". He was supposed to get "the outline of a reform action plan ... and further deliberations will take place in his presence", said an official release. I wrote here in December 2014, just before the retreat, that PSBs needed massive equity capital of ₹2.4 trillion by 2018 to meet the Basel III norms. If tough questions are not asked, the *Gyan Sangam* will tinker at the edges and preserve the status quo of PSBs. Nothing happened. A *Gyan Sangam* was held the next year too and then forgotten. Five years later PSBs are in worse shape.

Indradhanush: This seven-point scheme was announced in August 2015. It promised better senior-level appointments, setting up a Banks Board Bureau (BBB), pumping in more capital, reducing bad loans, empowering bank management, improving accountability, and better governance. It was another flop show. The first three were easy to do. A BBB was set up, but largely ignored, even after a revamp. The re-capitalisation of banks was announced in late 2018 and is happening in driblets.

The politics of it

Is reforming PSBs an economic objective at all? I have maintained that we know little about this government's goals and road map. We have to read between the lines and watch its actions. At the *Gyan Sangam*, Mr Modi asked banks to move to the second phase of the *Jan Dhan* — promote financial literacy by encouraging competitions in schools, much like mock Parliaments. He also instructed them to develop common strengths in software and advertising, help develop 20,000 to 25,000 *Swachhta* entrepreneurs per bank, offer loans to students (despite huge bad loans on this account) and avoid "lazy banking". Mr Modi also told the bankers that, as part of corporate social responsibility, they should take up one sector each year to play a positive role. A rather underwhelming agenda, when PSBs were facing a gigantic crisis.

Oh, and Jayant Sinha, minister of state for finance, had asserted in early 2015 "If we dilute stake in PSU banks now, then we will be diluting at distressed valuation. We need to increase price-to-book multiples of PSBs ... and bring them at par with private sector banks ... It is our responsibility to ensure that if we're going to dilute our stake, which is the stake of the people of India, we'll do it at an appropriate valuation". Valuations have collapsed since then as frauds and writeoffs have ballooned. As I said, politicians live in their own world.

The late Arun Jaitley, who was finance minister, had asked "why this obsession with big-bang reforms? We can achieve a lot of things through small incremental changes". True, only if small changes are not an excuse for avoiding critical reforms. Will the PSB mergers (more incrementalism) deal with the core issues debilitating PSBs — corruption and lack of incentives? Will they address the fact that borrowers today are far less dependent on PSBs, even if these become better-capitalised and better-governed! Weak bank mergers do not address tomorrow's challenges of capital, competition and technology. But that's another story.

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Consumers and climate change

BOOK REVIEW
BILL McKIBBEN

This book careens and skitters across the landscape of its topic, which means I now know a number of interesting things I didn't know when I picked it up: Netflix uses up 15 per cent of all the internet bandwidth on earth; shoppers return 35 per cent of the goods they buy online, which is as much as six times more than when they shop in stores; producing polyester for clothes emits as much carbon dioxide as 185 coal-fired power plants; a single fleece garment can shed 100,000 plastic microfibers in one washing.

There are lots of these factoids in *Inconspicuous Consumption*. Tatiana Schlossberg, who used to cover climate and environment for *The New York Times*, has not done a great deal of original reporting. But she has scoured the internet for pretty much every scary and fascinating statistic on her subject that you can imagine, and you come away from her book with a stronger sense of the sheer largeness of the human enterprise — the number of us now consuming, and the overwhelming effect of all that volume.

So, for instance, cashmere used to be a relatively rare luxury item. But the Chinese began to see an opportunity for an export market, and soon Inner Mongolia was surging in population - of herders, but mostly of goats, from five million in 1990 to 26 million in 2004. Those goats, in turn, have overgrazed much of the region's remarkable grasslands, turning them into desert.

One response to this would be to urge readers to buy less cashmere (and less fleece, and less cotton, and less viscose rayon, all of which Ms Schlossberg also covers). Indeed, her description of "fast fashion," with some stores having 20 "seasons" annually, leaves one thinking it would be smarter to wear whatever you're wearing forever, content in the understanding that it will swing in and out of style with some regularity. But it is to the author's credit that she doesn't, mainly, take this easy way out.

For 10 or 15 years beginning in the 1990s such consumer-driven environmentalism was a constant refrain, leading to endless disputations about paper towels and disposable diapers versus sponges and cotton nappies. When I picked up this book, I feared it might go down the same cul-de-sacs, but it doesn't, and for the obvious reason: That earlier campaign was essentially useless. Some fairly small percentage of people read those books, and an even smaller percentage took regular and clear action. And those of us working to contain this environmental disaster increasingly turned our attention to systems, and to the powerful actors within them.

Governments and corporations, of course, don't do such things automatically — they need citizens to push them. But it doesn't require every citizen to push in order to make change (since apathy cuts both ways, social scientists estimate that getting 3 or 4 per cent of people involved in a movement is often enough to force systemic change, whereas if they acted solely as consumers that same number would have relatively little effect). You can obviously do both, and all of us should try — but fighting for the Green New Deal makes more mathematical sense than trying to take on the planet one commodity at a time.

And that, interestingly, is where Ms Schlossberg seems to come out, even as she conducts her rambling tour of each of those commodities. When she writes about fuel, for instance, she goes into great detail: Whether Uber rides displace car trips or bus trips turns out to be both important and vexingly difficult to determine, for instance. But in the end, the changes we make in our transportation lives will matter mostly if we make them "as a collective." That is to say, instead of trying to figure out every single aspect of our lives, a carbon tax would have the effect of informing every one of those decisions, automatically and invisibly.

Many of the subjects Ms Schlossberg covers will be familiar. But there are a few places where her reporting covers issues that few people know about and everyone should. A dumb loophole in the relevant law, for instance, allows European utilities to claim that burning wood for electricity is "carbon-neutral," even though the science of the last decade makes it clear that turning trees into electricity actually sends a giant pulse of carbon into the atmosphere at precisely the moment when it could break the back of the climate system. Because of this loophole, the forests of the south-eastern United States are currently being turned into pellets and shipped across the Atlantic, a practice both climatically pointless and heartbreakingly destructive of one of the world's great ecosystems.

Schlossberg also reminds us regularly that justice is at issue in these decisions. A reason to fight for hyper-efficient air-conditioners is that poor people across Asia will need them badly on a planet they have done little to warm.

I confess that Schlossberg's writing style grates on me — the rate of cutesy asides per page is diabetic. But she deserves real credit for coming through her journey into the guts of the consumer machine with a clarifying insight: We aren't going to solve our problems on consumer at a time. We're going to need to do it as societies and civilizations, or not at all.

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Tatiana Schlossberg
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