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An ordinance tax boost

Short-term focus shifts to what extent the new measures will impact the fiscal deficit, accelerating non-tax revenue of the government

MUKESH BUTANI

Though there have been several precedents for Parliamentary Money Bills, such as income tax amendment, being promulgated by an Ordinance, it's rare to see such dramatic changes to income tax rates. Just as there is first to everything, last Friday's development is historical, though rational, given an urgent need for boosting confidence by way of directional tax policy change. There are two ways to view the change. Firstly, should this not have been a logical outcome, given how uncompetitive India as a nation was, getting to with effective tax rates crossing 35 per cent and if one factors the impact of dividend distribution tax (DDT), which was proving to be onerous for foreign investors, who could not claim foreign tax credit in their home country, overhaul was overdue. The DDT regime, introduced in 1997, to levy tax at 7.5 per cent with an objective to simplify collection regime over the years, became burdensome with 21 per cent. This coupled with expansion of buyback levies, including in the July 2019 Budget extended to listed companies, a part of which was rolled back on Friday, has left large corporates struggling to deal with the impact of tax. Given an average of 23 per cent corporate tax rate in the Organisation for Economic Co-operation and Development (OECD) member countries and a worldwide trend in past few years for reduction in taxes, India was coming under pressure from peer economies. India missed opportunities to moderate its tax rates which it could have done either in 2007, when fiscal deficit and current deficit targets seemed well positioned, and/or when the NDA came to power in 2014. The outcry for reduction in rates grew in situations of economic stress. Though, the government responded with phased reduction for small businesses (turn over less than ₹400 crore which was raised from ₹250 crore) over the past two Budgets, including the July 2019, businesses at large and foreign investors view India as amongst high taxed nation.

In the prevailing economic situation, a realisation amongst the mandarins of North and South block that monetary policy and other regulatory changes such as opening of the FDI, bank mergers were having lesser impact, and perhaps, some changes would take their own time to yield results, tax policy emerged as an option of last resort. With a challenge of subdued tax collections on direct and goods and services tax (GST) front, risking further slippage of fiscal deficit is always an option with policy makers, though the debate could be to what extent. Industries ask for a stimulus like 2008 crises or specific industry rate reduction was rightly frowned upon by the government, as is evident from the Friday's GST Council meeting.

Friday's rate reduction announcement conveys several messages. That the government is willing to take a bold directional tax policy step for moderating rates, certainly at the cost of fiscal slippage in short term. That it is willing to reconsider its misdirected steps on surcharge levies on FPIs. That it is willing to offer a discriminatory concessional rate to manufacturing entrepreneurs to boost its flagship "Make In India" programme. That its willing to seize a unique opportunity posed due to tariff wars and roll out a red carpet for domestic and foreign multinationals to boost manufacturing.

Sweeping changes, contrary to perception, is a well-crafted strategy. The option to opt for lower rate is subject to giving away tax holidays and incentives, which dragged down India's effective corporate tax rate to roughly 26 per cent, an argument policy makers used as a defence. Hitherto, the option is with the taxpayer to make a non-reversible election to choose between location/industry-based exemptions such as SEZ, backward area, low cost housing and accelerated depreciation and low tax rate. Last fortnight's cabinet decision to allow 100 per cent in contract manufacturing coupled with a competitive 17 per cent rate makes India a compelling case and on standalone basis, could turn into a game changer. Though, under the regime, there is a terminal date to commence manufacturing before March 31, 2023, interestingly, there is no sunset clause. This, in my view, signals a permanent move to moderate rates in general, and manufacturing. Of Course, the Parliament is well within its powers to raise taxes, but I wonder why any government would do that! The government preferred to deal with auto industry's slowdown by offering an accelerated tax depreciation from 15 to 30 per cent for motor cars and 30 to 45 per cent on motor lorries and motor taxi hire for acquisitions made after August 29. The accelerated rates are applicable will apply in the following years, an option better than a onetime reduced GST relief. Not much debated is the expansion of 2 per cent CSR spend to cover spending on incubators for conducting research in science, technology, medicine, and engineering. This opens a fresh credible avenue to direct CSR spends of large taxpayers.

I guess the short-term focus now shifts to what extent these measures will impact the fiscal deficit, accelerating non-tax revenue of the government, divestment targets, and in the medium term tax buoyancy due to upliftment of corporate profits and increased compliance.

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CHINESE WHISPERS

Time for action

The announcement of dates by the Election Commission for bypolls to nearly a dozen Uttar Pradesh Assembly seats has led to frenetic political activity in Lucknow. Ticket hopefuls of the ruling Bharatiya Janata Party (BJP) have started to lobby for nomination to seats of their choice. Most of these seats had fallen vacant after incumbent legislators were elected to the Lok Sabha in the 2019 general elections. It appears that many turncoats and a few sitting opposition legislators are also seeking the saffron party ticket. Recently, three Samajwadi Party legislators called upon Chief Minister Adityanath (*pictured*). While they termed it a courtesy call, the meeting created a flutter within the SP, and caused much consternation among BJP leaders who were vying for the ticket for the seats the SP MLAs represented.

Congress' pecuniary woes

The Congress party's funds crunch has meant it has to adopt novel ways to raise money. In Haryana, with the state unit's coffers nearly empty, the party is asking all ticket aspirants to donate money. The Haryana Assembly polls are going to be held on October 21. Ticket aspirants from the general category have been asked to contribute ₹5,000 to be considered for a party ticket, while those from the Scheduled Caste category have been asked to pay ₹2,000. Ticket aspirants, 900 to 1,000, are in the race for tickets for the 90 assembly seats, and the state unit is hoping to raise at least ₹50 lakh. Only recently, Tarun Bhandari, state unit treasurer, had issued notices to legislators and former legislators to contribute a month's salary or pension in a year. Barely a handful complied. The party hopes the money from ticket aspirants would take care of at least the day-to-day expenses of running party offices in the state.

RSS outreach

The Rashtriya Swayamsevak Sangh (RSS) is planning to intensify its outreach in the run-up to its Viajayadashami celebrations. Every year, the RSS marks Vijayadashami, or Dussehra, as its foundation day. The highlight of the event every year is a speech by the RSS chief. Leading up to the event this year, RSS chief Mohan Bhagwat will unveil a book titled *The RSS: Roadmaps for the 21st Century*, written by Sunil Ambekar. Ambekar is a senior RSS leader and organising secretary of the Akhil Bharatiya Vidyarthi Parishad, the students' wing of the RSS. The book discusses, among other things, the RSS' views on issues like homosexuality. Bhagwat will also meet journalists of foreign newspapers posted in India on September 24 in the national capital.

Cricket, culture and PSU bank merger

The market may take time to digest the BoB-Vijaya-Dena merger but it could be a template for the next four mergers to create "NextGen" mega banks

BANKER'S TRUST

TAMAL BANDYOPADHYAY

On June 9, around 2,000 Bank of Baroda (BoB) employees participated in a five-km "Su Run", flagged off by badminton champion Srikanth Kidambi at Jio Garden, Mumbai's Bandra Kurla Complex, where the bank is headquartered. That was one of the many segments of a team-building exercise, which will be replicated in other cities.

The sports culture is an import from Vijaya Bank which, along with Dena Bank, has been merged with BoB — the first such instance in the history of India's public sector banks (PSBs). Indeed, New Bank of India was merged with Punjab National Bank in 1993, but the context of that merger was different. The associate banks of the State Bank of India (SBI) got merged with the parent in 2017 for the sake of consolidation — a family affair. (Bharatiya Mahila Bank too got merged with the SBI but it was too small an entity.) Emboldened by the BoB experiment, the government has recently announced the merger of 10 PSBs into four mega "NextGen" banks to boost credit in Asia's third largest economy that aspires to reach the $5 trillion mark by 2025.

Cricketers Anil Kumble and Javagal Srinath, athlete Ashwini Nachappa, among others, were on Vijaya's payroll which excelled in basketball, kabaddi and cricket. BoB wants to imbibe that culture. To preserve the legacy of Vijaya and Dena, it is also creating museums in Bangalore and Mumbai, respectively, on the lines of its own museum in Baroda.

These are some of the softer aspects of the merger of 88-year old Vijaya and 81 year old Dena with 111 year old BoB. It is done but not dusted as yet and the completion of the process could extend to December 2020. On September 17, 2018, the merger was announced. After the boards of the three banks cleared the proposal, the government approved it on January 2, 2019.

For fair valuation, the three balance sheets were scrutinised to check the provisions made for the retirement benefits of 85,000 employees, bad assets (already identified and/or hidden) and the uniformity of accounting policies. For instance, the same asset could have been good on one bank's book and bad on the other's; also, one bank could have made provision even for non-fund based exposure while another had not. To harmonise the accounting practices, at least ₹6,000 crore extra capital was needed. The government stepped in with ₹5,042 crore and has promised to infuse another ₹7,000 crore.

Dena shareholders received 110 shares of BoB for every 1,000 shares they held; for Vijaya shareholders, 402 for every 1,000 shares. Since the BoB share has a face value of ₹2 and the other two ₹10, the discount was rather steep. No one complained as the swap ratios largely reflected the market price of the shares of the three banks.

FUTURISTIC Over the next five years, at least ₹9,500 crore will be generated through the sale of non-productive real estate, besides the other benefits arising out of business synergy

How is the merger being executed? Since the boards cleared the proposal, there have been at least 100 town hall meetings. The three CEOs — PS Jayakumar of BoB (who has been driving it), R A Sankara Narayanan of Vijaya (who later moved to head Canara Bank) and Karnam Sekar of Dena (now heading Indian Overseas Bank) — together addressed one-fifth of them. Then, there is the "pulse check" exercise — a survey of the employees' reaction to the merger, done anonymously — devised by management consulting firm BCG. Till now, two such surveys have gauged the employee happiness quotient and noted their suggestions on the merger.

To make it a smooth affair, "buddy branches" have been created: One BoB branch is linked to two branches of Vijaya and Dena to create camaraderie and understanding of the BoB way of doing business by the other two. This has been supplemented by "utsuk" training. At the BoB training centres, Vijaya and Dena employees have been continuously exposed to its policies and processes. Till the merger was formally consummated, the three CEOs were jointly writing the emails to all employees.

Even though they have lost their clout, the trade unions have been actively engaged in the process. That out of 15 chief general managers in the merged entity, three each have been chosen from Dena and Vijaya and out of 85,000 employees, only 240 are not continuing with the merged entity, say a lot about the care taken on the HR front. Roughly 10 per cent of the 9,500 branches of the new BoB will be relocated or merged with the others to avoid overlaps; around 540 of them have already been identified. These are logistics issues. For insights and inputs, many experts are engaged at the board and its various committees; they are not directors but attend such meetings by invitation.

The toughest part in any bank merger is technology. While all three have been using Finacle, a core banking product of Infosys Ltd, BoB has Finacle-10 while Vijaya and Dena have been using Finacle-7, that too two different versions, customised for each bank. In the first stage, there is inter-operability of three different tech platforms for six basic banking services — cash withdrawal, deposit, transfer of funds, balance enquiry, mini statement and stop payment instructions. Also, the entire corporate business of Dena and Vijaya, about 47 per cent of their loan books, has been shifted to the BoB platform. Now, the merged entity is following a "branch in branch" concept: In 1,000 Vijaya and Dena branches, there is a BoB desk to create all new businesses on its platform.

What are the benefits of the merger? In five states — Rajasthan, Uttar Pradesh, Karnataka, Gujarat and Maharashtra — BoB's market share in business has risen 10 per cent. Over the next five years, at least ₹9,500 crore will be generated through the sale of non-productive real estate, besides the other benefits arising out of business synergy. The low-cost current and savings account as a portion of the overall deposits is rising, so does the provision coverage ratio while the cost of income ratio is coming down.

These are good omens but the market doesn't seem to be convinced as yet. The combined market cap of the three entities on the day the merger was announced was close to ₹48,000 crore. That has slipped close to 25 per cent while Bank Nifty has risen. The market may take time to digest this merger but it could be a template for the next four mergers for creating mega banks.

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The 21st century's 'equaliser'

As recent attacks have shown, even dirt-cheap drones can cause a lot of damage

TECH-ENABLED

DEVANGSHU DATTA

In the 19th century, inventor "Colonel" Samuel Colt, sold his patented revolvers with the tagline, "God made man and Sam Colt made them equal". The killer app (literally!) for Colt's mass-produced guns was they were cheap, easy to carry, and reliable.

The drone is the 21st century's "equaliser". A few days ago, Houthi rebels from Yemen knocked out 5 per cent of global refining capacity using drones, which may have been loaded with homemade explosives to hit Saudi Arabian facilities in two locations. Some of the many drones used by the Houthis may cost as little as $45, while the most expensive may cost over $15,000. The American Predator and Reaper drones cost tens of millions each, and have far superior firepower and technology.

But as the Houthis have shown, in this and previous attacks, even dirt-cheap drones can cause a lot of damage. Some carry payloads of up to 40 kg of explosives. The more expensive have ranges of up to 1,500 km. Off-the-shelf civilian drones can be adapted to carry explosive payloads. These can be smuggled in kit form and assembled close to target.

Many non-state actors like Hamas, Hezbollah and Houthi use drones. In fact, drones seem to be ubiquitous in most of the ongoing Middle East conflicts with everybody using versions of these unmanned aerial vehicles. Most drones are small and fly close to the ground, so they are hard to pick up on radar. If swarms are launched, some may penetrate even sophisticated defences.

Conventional military forces started using drones extensively in the early 2000s. Yemen was an early proving ground for the vast US arsenal. Weapons like the Predator, which "loiter" for days over a specific location can be controlled by operators thousands of kilometres away.

Military drones are used for reconnaissance, and also to gun down specific people after the operator has zoomed in to identify an assassination target. These can also bomb targets with precision. They are also used to deliver equipment and supplies. Some are kamikaze — these fly into the target and explode. Stopping a drone can involve using nets to prevent access and fighters to shoot them down. It may also prevent decrypting and jamming of electronic signals used to control them.

Since drones come in many shapes and sizes, they have a wide variety of civilian uses as well. Police use them to survey crowds and watch sensitive locations. They are used extensively in disaster relief and rescue. They are used in crop spraying, ground-mapping, and underground surveys of airless mines and caves. The Japanese used miniature drones to survey the Fukushima reactor after the 2011 tsunami when radiation levels were too high for humans. There is talk of using drones as ambulances and air-taxis, and also to deliver pizza.

Making a cheap drone is not a big deal. A smart high-school kid could design and put together a drone, by machining and adding off-the-shelf components. China sells a vast array of civilian drones, mostly quad-copters of various sizes. Drones are also manufactured with varying degrees of sophistication by Israel, Iran, Turkey and others.

Military developments add many layers of technology. At least a dozen countries make military drones. These can be equipped with AI-based flight systems, and multiple sensors as well as cannon, lasers, missiles and bombs. The latest wrinkle is the fully-autonomous drone, which can find, and hit targets without operators actually pulling the trigger. Turkey, for instance, is said to be considering deploying such autonomous UAVs. This raises a new set of ethical questions.

India has many military drone defence projects on the anvil, including collaborations with Israel. It also buys drones from Israel. The Rustom II had its first test flights in 2018. Rustom II is part of the TAPAS 201 project, designed by the Aeronautical Development Establishment (ADE), the Bengaluru-based lab of DRDO. HAL-BEL are the fabricators. This is a multi-mission UAV which could carry out Intelligence, Surveillance and Reconnaissance (ISR) roles. The 2,000-kg UAV has a flight endurance of 24 hours and it carries a range of sensors and radars to make it all-weather. The ADE's Nishant, which also has a ISR profile, is already in service but it only has a mission time of about four-five hours.

Coming back to that analogy, drones are equalisers. A civilian can use a cheap handgun — a "Saturday night special", while an army may use machine guns. Both are lethal, albeit in varying degrees.

Militaries use high-tech drones equipped with massive armaments, autonomous AI systems and many sensors. Kids or non-state actors can use low-tech versions, carrying go-pro cameras and improvised explosive devices.

LETTERS

Parting shot

This refers to Shubhomoy Sikdar's report "Separation without tears" (September 19). As the frequency and the number of employees affected by layoffs increase, it is a good sign that Indian companies are adopting a structured and humane approach to the issue. Three concerns are critical. First, layoffs, particularly when a large number of employees are involved, should not come as a surprise. A company-wide awareness programme is the first step in which the company must explain why the move had become necessary and also what the company did do to try and prevent layoffs.

Second, there should be a well-thought out criteria to decide who will have to leave. These should be easy to understand and seen as fair and just by the workforce. One such criterion has been mentioned in the report. Third, the company that just laid off people should have a proper strategy to deal with the low morale of surviving employees. This may be the case if the people laid off are seen as victims of management whims. Effective use of outplacement services and if required retraining of the concerned employees for jobs available in the external labour market would also helps to restore morale.

Y G Chouksey Pune

Pushing for growth

This refers to "₹1.45 trn Diwali gift for India Inc" (September 20). By slashing the corporate tax rate to 22 per cent from 30 per cent, Union Finance Minister Nirmala Sitharaman has sent a clear message to India Inc that time has come to end the piecemeal approach to economic reforms. With the lowered corporate tax rates, the country's attractiveness as an investment destination has enhanced. No doubt, it would also incentivise firms relocating from countries like China to set up manufacturing units in India.

With corporate India now given the option to choose a lower tax rate without taking advantage of exemptions and incentives, the government has ushered in a conductive atmosphere to move towards a simplified tax architecture and reduction of tax litigation. While the latest measures suggest the government's belief in pushing growth through investment than boosting consumption, concerns over whether the government would be able to meet its budgeted fiscal deficit target of 3.3 per cent remains. To plug the anticipated revenue shortfall arising out of the latest measures, the government may opt for an aggressive disinvestment programme sooner than later.

M Jeyaram Tamil Nadu

A boon for passengers

In a game-changing move, the Indian Railways has shifted from the end-on generation system (EOG) to the head-on generation system (HOG) in trains having LHB rakes. This is an initiative taken by the national transporter to become more eco- and passenger-friendly. The system makes use of overhead electric supply to supply power to all the coaches of the train and puts a full-stop to LHB rake trains requiring two power cars for supplying power to the entire train. This is eco-friendly because now only one silent generator car will be used and the power from this car will be used only during emergency.

In the place of the second power car one luggage-cum-guard cum divyang compartment will be attached thereby accommodating more parcel and passengers especially the physically-challenged. This car has been developed in such a way that it will have the capability to convert power from the overhead cable supply for the entire train. The move from EOG to HOG is definitely going to reduce high expenditure cost, lessen noise and air pollution and will be a boon to passengers.

M Pradyu Kannur

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HAMBONE

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After the tax cut

All eyes now on how the govt manages its finances

Union Finance Minister Nirmala Sitharaman surprised everyone on Friday by slashing the corporate tax rate. Indian companies not availing of any exemption can now pay 22 per cent tax. The effective rate with surcharge and cess for large companies has been brought down from 34.94 per cent to 25.17 per cent. Further, companies getting incorporated in the manufacturing sector from October onwards, and starting production by March 31, 2023, will have the option of paying an effective corporate tax of 17.01 per cent.

While the government also extended relief for share buybacks and rolled back the enhanced surcharge on capital gains, introduced in the July Budget, the reduction in corporate tax is by far the biggest direct tax reform in many years, and will have multiple benefits. For one, it was a big sentiment booster, which was reflected in the biggest single-day rally in a decade on Dalal Street. The market now believes that the government can take bold decisions. Second, lower tax outflow will leave more cash with firms and can help boost investment. Third, aside from rate reduction, it is also a step forward in streamlining and simplifying the direct tax structure. Fourth, the competitive rate of taxation will increase India's attractiveness as an investment destination, especially for companies moving out of China. For instance, Vietnam and Thailand have 20 per cent as tax rate, while Indonesia's is at 25 per cent.

The big question, however, is whether the reduction will help revive economic activity in the near term. The tax cut will result in a revenue loss of ₹1.45 trillion. In the near term, lower tax outflow should allow companies to reduce prices and help revive demand to some extent, though growth is likely to remain muted, at the least in the next few quarters. The bigger issue is how the government manages the fiscal impact. Most economists believe that the corporate tax cut will push the fiscal deficit to close to 4 per cent of gross domestic product. Growth in tax collection is fairly muted and achieving the revenue target looks an almost impossible task. That the tax cut has complicated the fiscal situation is evident from the way the bond market behaved on Friday. Since lower collection will affect transfers to states, their finances would also come under pressure.

Therefore, it is possible that the fiscal deficit will go up, both for the Centre and the states, and the government will appropriate more savings from the system. This will put pressure on interest rates and affect economic activity in the private sector. While the Reserve Bank of India (RBI) is widely expected to cut the policy rate in October, a higher general government deficit will impede transmission. Also, large interventions by the RBI to keep a lid on bond yields through open market operations can potentially become incompatible with its inflation-targeting mandate. Since the Budget numbers have lost their relevance, the government would do well to come up with a fresh fiscal consolidation road map, which will help instil confidence in the system. This will also help the monetary policy committee to take a more informed decision.

Aside from allaying fiscal fears, the government should complement the tax cut decision with other structural reforms such as those of land and labour to improve the ease of doing business and further enhance India's competitiveness.

Phone banking, again

Bad ideas from India's socialist past should be avoided

Just after coming to power in 2014, the National Democratic Alliance (NDA) government had said that "phone calls from Delhi" would stop as far as public sector banks (PSB) were concerned. The NDA-II government seems to have forgotten that promise, as is evident from its announcement last week that PSBs would hold "Shamiana meetings" in 400 districts of the country so that smaller businesses and retail borrowers can access loans from banks and partner non-banking financial companies (NBFCs). Easy availability of credit during the festive season, the government believes, would have a multiplier effect and push up demand throughout the economy. The meetings — which are, to all intents and purposes, retitled "loan melas" from the socialist era — will begin shortly, and all the 400 districts are supposed to be covered by October 15. This, together with the announcement that banks would not declare any small enterprise's loan stressed till March 2020, makes it quite clear that the government is willing to suspend normal procedure to push liquidity into the system. It is not just enterprise loans that are to be incentivised — even home and vehicle loans are hoped to be stimulated.

While measures are indeed needed to restore credit availability to the most vulnerable sections of the economy, this is certainly not the way to go about it. It is as if no lessons have been learned from the past. Certainly, as this newspaper has reported, PSBs warned the finance ministry of the misguided nature of the proposal, pointing out that demand was as much of a constraint as supply. If indeed it is only a "perception" of a lack of liquidity that the finance ministry wishes to dispel, it should be asked whether it is willing to precipitate a fresh non-performing asset to get rid of a "perception". The PSBs have once again been revealed as little more than conduits for government policy, at the risk of their own health and of systemic stability. This is the exact opposite of the independence that PSBs need, and which is essential for sustainable growth in the medium term.

There is ample evidence of the danger that such loan melas pose on multiple levels to the financial system and the broader economy. Together with the forbearance demanded by the finance ministry of the PSBs, they will lead to the build-up of non-performing assets. Worse, this combination of policies will undermine the fragile credit culture that was just beginning to be built up. Credit that is directed, thanks to government diktat rather than the reasoned decisions of properly incentivised bankers, leads to a structural misallocation of resources across the broader economy. India is capital-scarce, and loan melas are among the worst ways of allocating capital if it is to be used productively. If the desire is to increase welfare and consumption, direct benefit transfers are a far better route. If the government, in fact, wishes to stimulate investment and productive capital, increasing bank independence, cleaning up their balance sheets, and resuscitating the NBFCs are the way to go about it. This socialist half-way house is among the worst.

ILLUSTRATION: AJAY MOHANTY

A step for the high growth strategy

Watch for the reward-to-risk ratio faced by private persons

SNAKES & LADDERS

AJAY SHAH

The most important problem in Indian macroeconomics is the decline in private investment. The decisions of private persons are shaped by the reward and risk from investing. When a business got ₹100 of profit before tax, the cash that went to the shareholder, under certain assumptions, was ₹43. With the reduced rate of corporate income tax, this goes up to about ₹48. This move is in the right direction. More needs to be done, to change the risk/reward analysis of private persons, to get back to high-growth arrangement. The greatest fiscal risk comes from low economic growth.

The part of aggregate demand that moves the most in Indian macroeconomics is corporate investment. There were two booms in recent decades, peaking in 1994-95 and 2007-08, and there are low values in the late 1990s and in recent years. To get back to growth, it is essential to get back to strong private investment.

How do private persons (domestic or foreign) make the decision to invest, either in a new firm or in the expansion of an existing firm? They look at the prospective reward-to-risk ratio, of the cash that is finally delivered back to the shareholder. For the moment, let us assume that a company gets to ₹100 of profit before tax. How much consumption does this give the owners? When various parties take a bite out of this ₹100, this reduces the benefits obtained by the owners, and thus reduces the reward-to-risk ratio.

By making certain assumptions about the exact values of CSR, corporate income tax, dividend distribution tax, and then the personal income tax paid by the owner, we estimate that before the Friday announcement, ₹100 of profit before tax would have yielded ₹43 to the owner. After Friday's announcement, this goes up to about ₹48 to the owner. The announcement has given a gain of about five percentage points. This is a useful progress.

When this shareholder goes on consume this ₹48 by purchasing goods and services, the government takes a next bite out of this through goods and services tax (GST).

Alongside, this is the question of risk, which comes in three parts. All investments face ordinary business risk, and this is perfectly fine. In addition, in the Indian environment, there are two additional components of risk. Firms face policy risk of events which can adversely impact their business model. As an example, in the Aadhaar case in the Supreme Court, firms who had built systems using Aadhaar were deprived of this infrastructure. Similarly, firms who had built systems using information from credit bureaus were recently deprived of this information access.

The third component of risk comes from the agencies. The Indian legal system contains numerous agencies, with high investigative powers, many threats of imprisonment, and weaknesses in the rule of law. Going to jail is a showstopper, but even if that is not in the picture, the expenditure on lawyers takes one more bite out of the cash flow. For a firm with a top line of ₹100 crore and a net profit of about ₹5 crore, payments to lawyers of about ₹1 crore a year are a large expense. Only when a firm reaches ₹1,000 crore of revenue does it feel safe about such legal expenses.

The private sector should be asked to bear normal business risk, and reap the fruits from innovating, taking business risk, and building a business. To the extent that the fruits of the labour are transferred to the government or lawyers, and to the extent that the business is vulnerable to policy risk and the agencies, this deters investment.

Policy makers can impact upon the reward-to-risk ratio by reducing tax rates, reducing policy risk, reducing the threat of the agencies, and reforming the legal system.

So far, we have focused on the desire of private persons to invest. Once the problems of the reward-to-risk ratio of private persons are addressed, private persons will nurture investment ideas. The next hurdle that they face is of a financial system that will fund investment projects. Both engines of the Indian financial system — banks and financial markets — are currently limping. Restoring the health of the financial system is required, in the high-growth strategy.

The high-growth strategy is thus a combination of changing the reward-to-risk ratio as seen by private persons, coupled with restoring the health of the financial system. The Friday's action is one element of the high-growth strategy.

There is the question of fiscal risk associated with reduced tax rates. We have to look beyond the short-term impact of this one decision, at the big picture. In Indian macro policy, there are only two choices for an environment of fiscal stability. Fiscal stability can be obtained through high growth coupled with loose fiscal policy. Alternatively, it can be obtained through low growth coupled with tight fiscal policy.

We have to ask which of these two scenarios is more palatable. The traditional answer in India was to have loose fiscal policy coupled with high growth. To return to this configuration, we need the high growth strategy. The Friday action is one move towards the high growth strategy.

The short-term budgetary impact of cutting tax rates will be smaller than what meets the eye. The distortion associated with a tax goes up in proportion to the tax rate squared. When a tax rate comes down, the distortion imposed upon the economy goes down, which bolsters growth. When a tax rate comes down, the effort made by private persons to evade the tax goes down. When a tax rate comes down, the power of the tax administration goes down.

For all these reasons, simple proportionality is never found when tax rates change. When a tax rate is raised, the tax revenues obtained always disappoint. When a tax rate is reduced, the reduction in revenue is smaller than what meets the eye. This gives cause for optimism in anticipating a relatively modest impact upon fiscal soundness.

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Cheering for toilets but with caution

DOWN TO EARTH

SUNITA NARAIN

This is big. No doubt about it. In the past four years, India has built 100 million toilets in its 600,000 villages and another 6.3 million in its cities. The country has been declared open defecation free (ODF) — a seemingly impossible task just some years ago. According to government estimates, by 2019, over 93 per cent of the country's households had access to toilets; in over 93 per cent of the villages, people do not defecate in the open; over 96 per cent who had access also used the toilets, suggesting an important change in behaviour. Then 99 per cent of the toilets are found to be well maintained and hygienic, and in 100 per cent of the toilets the excreta is "safely" disposed of — there is no pollution, and, in fact, in 95 per cent of the villages there is no stagnant water, no wastewater, and only minimal litter. Amazing.

How do we know this? The Ministry of Drinking Water and Sanitation (MoDWS) commissioned two private consultancies, IPE Global and Kantar, to conduct a nationwide survey, to be used for the future financing of the programme by the World Bank. The second phase of the National Annual Rural Sanitation Survey (NARSS) was done between November last year and February, and covered some 6,135 villages and some 92,411 households to assess the situation on the ground.

In addition, says the *Economic Survey 2018-19*, all built toilets have been geo-tagged and therefore these can be verified. Most importantly, the gains from the toilet programme are showing in health indicators — dramatic reduction in diarrhoea and malaria cases among children below five in districts with high coverage of toilets in households, says the survey, citing reports of the World Health Organization and the United Nations Children's Fund (Unicef).

There are no *ifs* or *buts* here — only an *and*. The evidence suggests that the country has managed to achieve a near impossible target. In fact, India's achievement will go a long way in the world meeting its Sustainable Development Goals of universal coverage to toilets and safe disposal of excreta. However, this success must be made sustainable — it must last. This is where the big risk lies. So, even as we take a moment to celebrate, we must not call off the toilet challenge. This is because there is still much to be done and much that can go wrong.

One, let's be clear that slippages happen in all programmes. It will not be different here. So, even if toilets are built and even if people have started using them, this trend can reverse in no time. When reporters of the fortnightly magazine *Down To Earth* traversed different districts of the country, looking at toilets, they found good and bad news. In districts of Uttar Pradesh — an earlier laggard state — change was visible on the ground. There were toilets and people — particularly women — were using these and wanted more. But in Haryana, declared ODF in 2017, there were signs of people slipping back to old habits of open defecation. This, when this state had been particularly recognised for investing in changing the behaviour of the people. But toilets get broken, they are not accessible or people just go back to doing what they have done for generations.

Two, there is the issue of excreta disposal. The NARSS 2018-19 uses an inadequate and erroneous definition of "safe" — it defines safe disposal if the toilet is connected to a septic tank with a soak pit, a single- or double-leach pit, or a drain. The fact is that this is only the system for containing the excreta, not its disposal. It is estimated that the bulk of the 100 million toilets built in rural India are either single- or twin-pit latrines — in other words, people defecate into a pit, which is emptied and then reused. There is no information where the excreta from the empty pit ends up — in waterbodies, drains, or fields. It could well be argued that the toilets are still new and so there is still no faecal matter to be disposed of or emptied. But it will happen. And, let's be clear, if this excreta is not managed, it will end up adding to the health burden — the toilet will not be the source of contamination, but soil and water contamination will take away the health gains.

Thirdly, there is the issue of credibility of the assessments — crucial to know that we are on track. Currently, all studies are commissioned by the project funders or its proponent ministry. I have no reason to doubt the methodology or results of these massive surveys. But it is also fair to say that nothing in India can ever be so black or white — the over 99 per cent success story just does not square with the black, grey and white reality of the country that we all know. So, there is reason to ask for differently done assessments by many more institutions and with many more colours. Because there is one fact that even our good news toilet story must remember: If we all turn into cheerleaders then there will be no team to cheer.

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Lost opportunities in the Hindu Kush

BOOK REVIEW

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Raghvendra Singh's lengthy book on the past, present and future of what the British called the North-West Frontier Province (NWFP) and Pakistan renamed as Khyber-Pakhtoonkhwa conforms to the current trend of blaming Jawaharlal Nehru for many of India's woes. Mr Singh is a retired civil servant from the Indian Administrative Service whose bent for history was presumably stoked by an appointment as head of the National Archives of India. He has recently been appointed chief of the Development of Museums and Cultural Spaces.

Mr Singh makes a simple argument in his book: In 1946, the overwhelmingly Muslim NWFP elected a Congress government, which was firmly in the saddle as British and Indian leaders discussed the modalities of partition. Were the NWFP leaders to opt for joining India — as seemed likely at that time — the two-nation theory that Mohammad Ali Jinnah and the Muslim League propagated would have been severely discredited. Further, Pakistan's strategic viability would have been compromised, especially if Kashmir acceded to India, creating geographical contiguity with the NWFP. Given the popularity of the NWFP chief minister, Khan Abdul Jabbar Khan (universally known as Dr Khan Saheb), and his iconic brother, Khan Abdul Ghaffar Khan, who was also known as Badshah Khan or the Frontier Gandhi, both of them politically and ideologically linked with Mahatma Gandhi and the Congress, the NWFP seemed likely to opt for India. However, British political leaders, who were eyeing the exits from the subcontinent, were convinced of the strategic necessity of partitioning India and having Pakistan as an assured ally, rather than relying on the favour of an undivided subcontinent. They believed a friendly Pakistan would enable London to retain its influence in the oil-rich Persian Gulf, as well as provide air routes through the region. And so, with London hell-bent on partitioning India, it directed a procession of British villains — notably NWFP governor Sir Olaf Caroe and Viceroy Lord Louis Mountbatten — to conspire with Nehru to ensure that Pakistan eventually got the NWFP. This thesis bears striking similarities with arguments made by others about how Nehru lost much of Jammu & Kashmir (J&K) through mismanagement at best, if not outright skulduggery.

This argument fails to convince, deploying the benefit of hindsight while remaining oblivious to the enormous complexities facing Indian decision-making at that time. Indian leaders of that period had no experience of statecraft and had never been allowed by the British to handle security policy. Furthermore, all contemporary accounts of that time reveal the preoccupation with integrating the key princely states such as Hyderabad, rather than focusing on J&K and the NWFP. There was a genuine and valid fear of Balkanisation. Nor do the "incompetence" arguments take into account the capacity deficit that hamstrung the Indian leadership, especially in political intelligence and military power. Given these limited circumstances, the author appears to have underestimated the difficulties of forming two countries from the 17 provinces and 565 princely states the British left behind.

Even so, the author has mined multiple sources to bring out a detailed historiography of a complex and little-studied region. He has followed an interesting methodology — adopting a chronological approach up to the World Wars, and then taking up the narrative through the inter-war years through chapter-length studies of the key personalities in the great NWFP drama. The protagonists include British officials and administrators Caroe and Sir George Cunningham; British Viceroys General Archibald Wavell and Mountbatten; the trio of Badshah Khan, Dr Khan Sahib, and Abdul Qayoom Khan; and, of course, the central decision-makers, Nehru and Jinnah. In dealing with these personalities, the author weaves back and forth in time, sometimes confusingly, throwing up themes and leaving it to the reader to interpret the narrative.

Some of these portraits make for fascinating reading. About the stoic, spartan Wavell he quotes: "On he went up the great, bare staircase of his duty, uncheered and undepressed." He never got along with Churchill, whose "main concern whenever Wavell was home on consultations was how to send him back to New Delhi." About the charismatic Mountbatten, whom the author clearly dislikes: "He was considered a remote and irresponsible master who sat in his luxurious office at Kandy (Sri Lanka) as a Zeus on Olympus, coming down once in a while to make sport with the lives of men fighting in a jungle, cool, charming and godlike in his taste for other people's confusions." The author writes that when Mountbatten commanded the fifth destroyer flotilla, the professional opinion about him was: "There is nobody better to be with in a tight spot than Dickie Mountbatten and nobody likely to get you into one sooner."

The book finishes with a chapter, best described as "potted strategy", that recounts the geo-strategic importance of the Hindu Kush mountains, which straddle the tribal areas of the NWFP. The author points out that all migration along the "Hindu Kush Highway" from Afghanistan has taken place in an easterly direction towards India. The only example of the westerly move was the spread of Buddhism towards China. He warns that this holds a cautionary tale for India, especially with the Chinese expanding into the region and building "belt and road initiative" projects in Pakistan.

The strong points of this book are its historiographical research into a region of relevance, even if the reader does not necessarily agree with the conclusions the author draws. It is well produced, footnoted and indexed and should be widely read by students of the endless Af-Pak confrontation.

INDIA'S LOST FRONTIER
The Story of the North-West Frontier Province of Pakistan
Raghvendra Singh
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