Opinion

MONDAY, SEPTEMBER 23, 2019

ERODING PUBLIC TRUST

Congress leader, Priyanka Gandhi

Common people invest their hard earned money in LIC for future security, but the BJP government is investing LIC money in loss-making companies, shattering their trust

No ambitious action sans climate financing

India rightly links any scope for bolder climate action by developing nations to rich nations meeting funding pledges

AHEAD OF THE United Nations Climate Action Summit that will call for stepping up climate action, India has done well to squarely put the ball in the court of developed nations by saying, that developing nations can do this only if developed nations fulfil their commitments towards climate action financing and technology transfer. In a discussion paper titled *Climate Summit for Enhanced Action: A Financial Perspective from India*, the Union government makes it clear that, with developed nations not contributing to climate action finance in the manner negotiated in different climate accords, India "can only aspire to implement its already promised climate actions and do equally well or better in comparison to economies with similar levels of development". Thus, India, the government says, "may only be in a position to clarify or elaborate its post 2020 climate actions already pledged in it NDCs (nationally determined contributions)" at the summit. As per Climate Action Tracker (CAT), India is one of the just seven nations—none of these is a developed country—whose climate pledges, if all countries were at similar levels, could prevent a >2°C rise in temperature from pre-industrial levels.

India's commitments under the Paris Agreement include 40% non-fossil fuel based power generation capacity by 2030. The costs of technology in the renewables space, though inching down over the past few years, is still high. With funding from developed nations barely a trickle, India and other developing nations must take hard calls on growth *vis-a-vis* climate change action. India, thus, has said that it will 'suitably recalibrate' its action only after the global stock-take of progress under the Paris Agreement takes place in 2023. While global climate negotiations have focused on the principle of common but differentiated responsibilities, and countries' respective capabilities—this acknowledges the fact that developed countries have shrunk the emissions budget for developing nations—the fact is that developed nations gave just $38 billion in climate finance in 2016, against the $100 billion a year by 2020 that had been agreed to in the 2009 climate negotiations. The amount is a trifle compared to the estimated costs of climate action. Developing countries need $4 trillion to implement their NDCs. India alone will require $206 billion, at 2014-15 prices, between 2015 and 2030. Also, the amount pledged to the Green Climate Fund (GCF) stands at a meagre $10.3 billion. India doesn't mince words, saying, "the means to achieved climate goals is not commensurate to the urgency shown, nor there is any seriousness in discourse on climate finance". Technology transfer is also a sore point. India has invoked Article 4.7 of the United Nations Framework Convention on Climate Change, that talks of developing country parties being responsible for implementing their climate-action commitments to the extent they receive financial and technological support from developed nations. India highlights its sense of betrayal by the developed nations, referring to how it had announced its INDC at Paris "being sanguine about unencumbered availability of clean technologies and financial resources from around the world." It calls upon developed countries to "enhance their support ... through adequate provision of finance, technology transfer, and capacity building".

India has performed in an exemplary manner—it was required to reduce emission intensity by 20-25% from 2005 levels by 2020, but the country clocked 21% between 2005 and 2014. How fecklessly developed countries have looked at their roles offers a contrast—of the $10.3 billion pledged to the GCF so far, only $7.23 billion has been deposited and a mere $0.39 billion has been disbursed. Of this, India has received only $177 million. Unless developing nations force their developed counterparts to change course, the climate agenda would fail, with devastating consequences for all.

In the right direction

Maharashtra experiment can inform commercial drone policy

FOUR YEARS AFTER imposing a blanket ban on drone operations, the government brought in the Civil Aviation Regulations (CAR) 1.0 in December 2018, which set the regulatory framework for civilian drone operations. The government launched DigitalSky, a portal to support drone operators and manufacturers, but stringent conditions and rules have constrained drone operations from taking off meaningfully. Registration was made compulsory for drones in a specific weight category and at higher altitudes, along with GPS and other safety measures. But, the no-permission-no-takeoff rule (NPNT)—this requires a drone to get a digital certificate each time it flies—was something that industry manufacturers were hardly prepared to incorporate. Maharashtra's latest initiative, thus, may usher in a more liberalised regulatory framework, provided it doesn't run afoul of the central norms. According to a *Times of India* report, the state has signed an MoU with Zipline, a US-based company, to use drones for faster delivery of life-saving medicines in health centres. Earlier this year, Maharashtra became the first state to launch a drone-based aerial survey.

This opens up the space for commercial operations, as companies would need to go beyond the remit of CAR 1.0, which stipulates that a drone cannot be operated from a remote location. The government put out a new policy document in January this year, and announced pilots for experiments in beyond visual line of sight (BVLOS) in May; Maharashtra's adoption may fast-track the process. Besides, it may also help formulate guidelines on autonomous operations, which are also a part of draft rules. The government had allowed manned-drone services, but autonomous driving, and BVLOS are essential for commercial success. For instance, if an Amazon were to use drones for delivery, employing a pilot for each one, ensuring that they are not outside the line of sight of the ground-based operator would make drone operations costly and unviable. With rules stipulating that drones cannot be operated from a moving vehicle, it was not clear how they could ever be used for delivery in the first place.

More than that, the government also needs to relax guidelines on licenses and operations. India did well to follow the example of the UK, Australia, and other countries in forming rules for operations, such as NPNT, but even these countries have watered down such provisions. Licensing of drones cannot be the same as aircraft licensing. So, it needs a new department for drone regulation, either within or apart from the DGCA. Further, monitoring needs to happen in real-time, and the DGCA, even with the DigitalSky, has no way to ensure this. The sector can't wait another four years for a timely delivery.

WaterACCESS

Having to fetch water from a great distance has significant negative outcomes for household health

A RECENT STUDY by two UK scholars notes that fetching water from distant places can result in adverse health outcomes. It claims that the ideal time for fetching water should not be beyond 30 minutes. The research, due to be published in the upcoming issue of *International Journal of Hygiene and Environmental Health*, surveyed 2.7 million people across 41 countries to find that in 2017, 206 million spent more than this ideal time to fetch water, and 435 million relied on unimproved water sources. It notes that women and children from low-income countries are most affected by the lack of access to water.

Off-plot water access results in multiple trips, leading to extreme exhaustion, and consumption of unsafe water. Further, children left at home when adults go to fetch water are at a greater health and safety risk than those under adult supervision; in areas where children go to fetch water, the likelihood of diarrhoea in the under-five age group is 10-15% higher than normal. The exhaustion from fetching water was also found to affect breast-feeding behaviour, impeding postnatal care and infant nutrition. Pre-existing research has found that reduction in hours spent on fetching water due to access to taps halves risk of child death per month. The formation of the 'Jal Shakti' ministry, and, with proper implementation, the 'Nal se Jal' scheme might help tackle the problem of water access that grips urban and rural Indian households, and one may see better health outcomes. However, with the growing water crisis across the world, concrete conservation steps must accompany measures geared at easing of access.

CHANGING PARADIGM

INDIA'S IT SERVICES INDUSTRY HAS TOO MANY PROJECT MANAGERS IN THE MIDDLE, TOO MANY GENERALISTS ALL OVER, TOO MANY LEGACY SKILLS, AND TOO MANY PEOPLE AT THE TOP

Rebooting the Indian IT industry

MANISH SABHARWAL
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Views are personal

GOOD DOCTORS ARE mindful of iatrogenic risks—the unintended consequence of the treatments they prescribe. The HR adage that culture eats strategy for breakfast is under re-evaluation because of the unintended consequences of strong, or monoclonal cultures in times of rapid change, lower cognitive diversity, resistance to change, Nuremberg excuse (we were following orders), group-think (the warmth at the centre of the herd) and much else. Culture will always be important for the basics, like integrity and teamwork, but the weaknesses of strong cultures in a rapidly changing world need thoughtful organisation structures. Questioning structure is particularly relevant for India's IT services industry, which needs transitioning from the hormonal exuberance of adolescence to the cruising speed of adulthood. We would like to make the case that their organisation structures are morphing from cylinders to hour glasses (broad at the top and bottom, but thin in the middle) as an interim stop on their way back to pyramids, but they need to target becoming Eiffel towers (very thin vertical structure with a broad base).

Good times breed their own problems; an unintended consequence of 30 years of good times for India's IT services industry means that their pyramids have become cylinders, with too many project managers in the middle, too many generalists all over, too many legacy skills, too many people at the top, too many people in non-revenue accountability roles, time-bound promotions, and diffused performance management. But, future product, and labour markets for Indian IT service companies are very different from those in the past. The competition for talent is brutal—India's 15,000 service companies compete with over 600 captive operations (software for non-IT companies by their own Indian subsidiaries), and 400 product operations (software being written for IT companies by their own Indian subsidiaries). The global backlash against immigration in rich countries is, so far, more bark than bite, but uncertainty over overseas visa regimes, like H1B, are set to continue. This needs moving to a blended revenue realisation per employee. Rapid change seeds a bias against tenure, which is inversely correlated with niche skills. Overall, client budgets are shifting from 'run the business' to 'change the business'; this creates a scramble for people with skill adjacencies, leaving a mass of single-skilled people, and so called people managers on the bench, as work rapidly leaves the waterfall model for the DevOps model. Essentially, with their high people costs as a percentage of revenue, IT services companies need to reimagine their people-supply-chains by discarding the 80% utilisation paradigm for the differentiated made-to-stock, made-to-order, and on-demand talent ecosystems.

This has important implications for everybody. Organisations need to adopt the up-or-out threshold of the army (if you are not shortlisted for promotion beyond Colonel, you retire at 50) because the fresher-versus-experienced ratio needs continuous gardening. This will mean lower fresher hiring, and accelerating the decline of engineering college capacity (it peaked at 1.7 million per year, but may now effectively be lower than 1.2 million). Without devalued designations on offer, HR will have to work harder to sell quality of work, state of flow, quality of work relationships, and perception of fairness. Organisations will have to invest more in re-skilling; companies can't manufacture their own employees, but they need to invest in repair and upgrade by thinking about four campuses of learning (onsite, online, on-the-job, and on campus) at different price points, and different levels of learning effectiveness. Hiring, deployment, and skilling are no longer core activities in IT companies; they will not have an Uber-type relationship with employees for quite some time, but the past contract, or relationship, is dying, if not dead. Salaries will have to morph from the high levels of the past to basic plus deployment premium, plus skill premium, plus profit-sharing. Employees will have to take ownership of their relevance, skill levels, and careers much more than in the past. Organisations will have to rethink recognition and appraisal—the metrics for evaluation—more towards skill and contribution rather than tenure and longevity. Organisation structures are being framed more subtly—team extension models, where employees across several countries/locations work simultaneously on different facets of the same project/deliverable, depending upon their competence/capability. This moves away from the cost arbitrage model and leverages skills; it is time-effective, process-efficient, and can easily be dismantled, without much agony to team members.

As IT companies revert their organisation structures from pyramids to cylinder and Eiffel Towers, they will have to rethink the staffing profile of their big bases

As IT companies revert their organisation structures from pyramids to cylinder and Eiffel Towers, they will have to rethink the staffing profile of their big bases as a bunch of concentric circles. The core circle will always be a bunch of permanent employees, but the next circle will be apprentices—kids they are taking for a test drive. The next circle will be direct fixed-term contracts—senior people they are taking for a test drive, or alumni they are using for surge capacity. The next circle will be third-party fixed-term contracts—people they use for specialised skills, or surge capacity. The outermost circle will be freelancers.

Many people worrying about the future of jobs in India's IT industry because of machine learning, and AI are focussing on the wrong variable. India's IT cluster now has critical mass, and high switching costs because of a robust people-supply-chain, customer trust, and employee experience. We bet that current IT employment of 4.5 million will reach 10 million soon. What is less clear is which organisation will thrive and survive in the new world; Harvard economist Schumpeter described capitalism as a hotel which is always full, but the guests keep changing. The future winners will be those that morph their organisation structures to an Eiffel Tower.

Will a weaker rupee help exports?

It is questionable whether a weaker rupee would directly lead to higher exports. In the recent past, the correlation has been minuscule

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Views are personal

THE HEAD OF a large equity fund I met at a restaurant last weekend greeted me with "80?" A very smart analyst I know sent me a report a couple of months ago forecasting 80 by mid-2020; his analysis was quite convincing, except for the fact that this has been his view for at least two years. A friend of mine in the hospitality business said he needs 90 for sustained profitability—everybody's going to Bangkok and Dubai was his complaint. Another friend, who I sometimes consult on the "right" value of the rupee for his business—which competes with imports from China and has some exports—very matter-of-factly talked about 75-80. But, the loudest of such views was in an article by one of the by-now Grand Old Men of Indian finance—Shankar Acharya, who was Chief Economic Advisor to the government in the heydays of liberalisation—who simply stated the rupee is "hugely overvalued".

I generally stay away from such judgements, although recent data showing that private outflows under the LRS are substantially higher than previous periods, does appear to suggest that Indians are finding it cheap to travel overseas, or they are worried about an impending sharp decline in the rupee or both.

The problem, though, is that even if the rupee were to weaken sharply, the impact on the economy would not necessarily be positive. Sure, it would likely reduce private outflows, but it is questionable whether a weaker rupee would directly lead to higher exports. In the recent past, the correlation has been minuscule.

Between 2013-14 and 2018-19, while the rupee fell by 32% (from 53 to around 70), India's exports grew by—hold your breath—a sum total of 5%, from $314 bn to $329 bn. Over the same period, Thailand's exports grew at twice the pace ours did—from $225 bn to $252 bn; however, the Thai baht stayed more or less steady against the dollar over the entire period. Vietnam saw its exports jump by a huge 84%, from $132 bn to $243 bn, with relatively modest currency depreciation (about 10%, from 21,080 to 23,228 to the dollar). Clearly, the global market was alive and well, certainly for Vietnam, where a modest currency depreciation led to an outsize jump in exports.

Our problems, as is well known, are structural, having to do with weak, if improving infrastructure, a poorly-trained workforce, complicated with anti-competitive labour laws, and a government that seems almost endemically unable to create a stable investment environment. For most companies, exports have long been very profitable, more so than domestic sales, but here, there has been near-zero investment in export capacities over the last several years. In fact, many large exporters are restructuring their businesses to invest in assets overseas, which, incidentally may support the view that the rupee is stronger than it "should" be.

Going forward, the export situation may well be even more difficult, with global growth showing definitive signs of slowing, confirmed by the fact that oil prices have behaved remarkably calmly despite the bombing of Saudi's oil assets. Both the ECB and the Fed have just cut rates; a study referred to by the Fed suggested that the on-again off-again trade war could cut as much as 1% off the US GDP growth. In this kind of environment, rupee weakness will most likely be "wasted" in terms of pushing exports, and will only serve to amplify some of the negatives in the economy—higher costs (and possibly interest rates), more volatility and increased difficulty with risk management.

Of course, the market is indifferent to any of this, and whether the rupee will fall or not simply depends on the obvious rule of supply and demand. The key drivers of demand for dollars are the current account deficit and investment outflows. With the CAD showing signs of moderating as a result of the domestic slowdown—August imports fell 13% from the previous year—investment outflows remain the only real force to drive the rupee lower.

Indeed, the sudden outflow of about $2 bn in August did push the rupee quickly through 70 to 72+, but it has recovered since then, despite continuing FPI selling in the equity markets. To be sure, sustained outflows could push the rupee sharply lower—in 2018, the only year where there were net outflows (of about $11 bn), the rupee fell by about 10% (63.80 to about 70).

The big question is whether this will materialise.

It does seem that India's government yield of 6-6.5% could continue to draw investment interest, despite the fumbling economy and nervous rupee

Global investment sentiment remains remarkably buoyant, given the slowdown and multiple political uncertainties across the globe. But, investors are driven by simple arithmetic and with interest rates low, lower, lowest in the developed markets, it does seem that India's government yield of 6-6.5% could continue to draw investment interest, despite the fumbling economy and nervous rupee.

Perhaps reflecting this, a survey conducted by UBS indicated that the majority of firms (34%) expect the domestic currency rupee to trade in the 67-70 range against the US dollar ($) over the next 12 months. "Around a quarter of firms expect it to weaken towards the 70-75 range. Overall, firms expect INR to recover to an average of 67-68 in the next 12 months."

LETTERS TO THE EDITOR

Vaping sans paper, writing's on the wall?

A blanket-ban on e-cigarettes is a welcome step in the larger public interest as teenagers usually tend to vape for recreation, which can aggravate health-concerns. That said, e-cigarettes are a comparatively better alternative as they do not produce any tar, and keep health-risks due to tobacco smoking at bay. The community believes vaping, too, offers an inherent motivation to quit smoking in the longer run, and perceives the product as an aid to smoking cessation. However, it is important to develop nicotine-free substitutes in order to completely discourage the use of liquid flavours. Influential marketing messages echo well-established themes and attractive benefits, which ultimately mirror in consumer-habits. A superior evidence is needed to conclusively ascertain whether e-cigarettes can be a root-cause of respiratory diseases in humans. It is difficult to portray a black-or-white picture, and categorise e-cigarettes as simply beneficial or harmful. While in some circumstances, such as increased consumption by teenagers, their adverse effects clearly warrant concern, in other cases, where traditional smokers use vaping to curb their tobacco-craving, they offer an opportunity to reduce smoking-related illness. For a stringent/ethical stance to be enforced as a norm on the ground, it is prudent that authorities adhere to the rigidity in the longer run too, and review the increasing active/passive exposure of the larger population to numerous proven toxicants and carcinogens present in combustible traditional cigarettes viz. tobacco, nicotine, tar, carbon monoxide, arsenic, ammonia, acetone, toluene and methylamine—apparently a much graver concern than inhalation of aerosol/formaldehyde and acrolein vapours, in smaller amounts, having lesser side-effects.

— Girish Lalwani, Delhi

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STIMULUS MEASURES

Is it really a booster dose for the economy?

The best part of these measures is that the government acknowledges the intensity of the problem. However, much more is expected from the government on factor markets reforms for sustainable growth in the medium-term

AS WE NEAR THE end of the second quarter of this financial year (2019-20), it is evident that the Indian economy has expanded at its slowest pace in over six years in the April-June quarter—at 5% against the projected 5.7%—on the back of slowing investment growth and weak consumption demand. The sectors that led to a decline in growth in Q1 in 2019-20 are manufacturing (with a growth of 0.6% vis-à-vis 12.1% in Q1 of 2018-19), agriculture and allied (2% against 5.1% in 2018-19), and construction (5.7% vis-à-vis 9.6% in 2018-19). High-frequency and important indicators such as automobile sales, domestic air traffic and consumer durables are on a continuous downturn, indicating a slowdown in private consumption. The upper-middle class households are holding back given the slowdown and the demand by this section of the population has saturated. With the slowdown of the economy, the growing new middle class is also not spending enough, leading to a decline in demand. Additionally, the uncertainty in trade and investment arising out of the US-China tariff war and the geopolitical issues threatening a stable oil supply weigh down the growth sentiments and business confidence in India.

Measures to pump in liquidity and boost private investment, along with FDI reforms, are expected to turn around the Indian economy in the short-term

To pull the economy out from the slowdown, finance minister Nirmala Sitharaman has announced a series of stimulus measures—credit support, tax rebates, support to the MSME sector, FDI reforms with easing norms—to revive economic growth. Some of the positive steps for the MSME sector include pending GST refunds (worth Rs 4,000-5,000 crore) due to MSMEs to be executed within 30 days and all future GST refunds to be paid back within 60 days. Measures for better credit flow to MSMEs and time-bound online tracking of loan applications are welcome steps.

Following the RBI recommendation, the MSME Act has been amended to ensure a single definition of MSMEs based on annual turnover, which will make manufacturing growth-oriented and encourage ease of doing business. Banks will issue improved OTS (one-time settlement) policy and launch check book approach to help MSMEs and retail borrowers settle their over-dues.

In the financial markets domain, Section 56-2B of the Income-tax Act will not be applicable to the registered start-ups, and a dedicated cell will be set up at the Central Board of Direct Taxes (CBDT) to address the tax problems of start-ups, where start-ups could be identified as MSMEs. Although there is nothing directly for the automobile sector—which is one of the major success stories of the Indian economy—the change in the definition of MSMEs would help auto companies, especially the retailers, to avail incentives and benefit from MSME schemes. With better credit facilities (Rs 70,000 crore to the public sector banks for additional credit facilities), more and more MSMEs can get the push in order to contribute to the agricultural sector's revenue.

In continuation of the first set of measures announced on August 23, the finance minister again announced measures on September 14 to boost the economy, mostly focusing on export and housing sectors—including offering credit support of Rs 36,000-68,000 crore in priority sector lending, higher insurance cover for lending working capital for exports, improving technology to reduce the turnaround time for exports, introducing fully electronic refund mechanism for GST and a scheme to replace MEIS for Remission of Duties or Taxes on Export Products (RoDTEP). All these measures will increase liquidity and allow better credit facilities to small and medium exporters. The finance minister also announced a special Rs 10,000 crore fund for last-mile funding for non-NPA and non-NCLT housing projects, and liquidity support of Rs 30,000 crore to HFCs (housing finance companies) to make liquidity available for infrastructure.

The economic stimulus package also includes measures for consolidation and recapitalisation of PSBs. The government has announced an upfront release of Rs 70,000 crore to PSBs for additional credit facilities and plans to release another Rs 5 lakh crore to banks in a phased manner. Consolidation of state-run banks is expected to bring in efficiency, bigger project funding and spur private investment. Over the years, a huge amount of investment is made in technology and compliance, but the return on this investment falls short for smaller banks. Hence, a merger will help PSBs that are sub-par in size. A bigger bank implies more independent decision-making and specialised services. The size and scale help the bank's management not only deal with government, but also carry out faster decision-making and makes them better placed for loan monitoring, overseeing the end-use of funds and better recovery. However, the efficiency of the banking sector depends more on governance reforms in this sector. Better governance including composition of boards, succession planning similar to private sector banks, attracting top-notch GMs and CGMs, and competitive executive compensation are some of the necessary steps.

The biggest of all recent measures was announced on September 20, where the effective tax rate for the corporate sector has been reduced to 25.2% from 35% including all surcharges. This big move will make the effective tax rate 22-30%, comparable to Asian countries, and will certainly give a lot of relief to companies affected by lack of demand. Further, domestic firms incorporated on or after October 1, 2019, will pay income tax at only 15%. This will encourage firms to invest. Overall, the slashing of the corporate tax rate and lower income tax will boost private investment, which has been slowing down over the last decade, although it has a huge cost to fiscal balance.

All these measures to pump in liquidity and boost private investment, along with FDI reforms, are expected to turn around the Indian economy in the short-term. The best part of these stimulus measures is that the government acknowledges the intensity of the problem. However, much more is expected from the government on factor markets reforms for sustainable growth in the medium-term.

Making the most of PSB mergers

HIMANSHU ARORA

The author works with the Economic Advisory Council to the PM, NITI Aayog. Views are personal

THE GOVERNMENT HAS unveiled a mega plan to merge 10 public sector banks (PSBs) into four, thereby reducing the number of state-owned banks from 18 to 12. Under the consolidation process, the Oriental Bank of Commerce and the United Bank of India will be merged in the Punjab National Bank; the Syndicate Bank with the Canara bank; the Andhra Bank and the Corporation Bank with the Union Bank of India; and the Allahabad Bank with the Indian Bank. The aim is to create next-generation financial institutions with stronger balance sheets and bigger lending appetite.

The proposal to merge poorly-managed banks with well-governed ones has been recommended by numerous committees since the 1990s. A committee under the chairmanship of M Narasimhan recommended the number of PSBs be reduced and 3-4 large banks should be developed as international banks. The report envisaged a three-tier system with 3-4 large banks at the top, 8-10 banks having nation-wide presence catering to the needs of industrial and infrastructural sectors, and a large number of regional rural and local banks focusing on agriculture and rural sector.

Experts believe that reducing the number of state-owned banks will improve the collective performance of the banking system. It will bring economies of scale through optimal use of capital and resources, and ensure higher technical efficiency with higher profitability. The additional resources can be used in hiring domain experts and enhancing manpower, the absence of which is partly responsible for the NPA crisis. The logic being that bigger and well-managed banks are better equipped to respond to the lobg-term finance needs of industrial and infrastructure sectors. Further, PSBs—under stress due to NPAs—would find themselves adequately capitalised. This is expected to aid the banking sector in restart the lending exercise to the productive sectors.

The next logical step should be to find the right experts who can steer this consolidation—a move that requires a slew of reforms. Governance of PSBs has been a major challenge from the time these banks were nationalised. The Narasimhan committee recommended that banking boards be empowered and adopt a professional corporate strategy.

The proposed merger of PSBs is a good starting point for reforming the Indian banking system, but it has to be followed by good governance

The problems of PSBs are structural. The merged banks may fail if governance structures are not reformed. This must be addressed. Accordingly, post-merger, the focus should be on effective governance reforms. The roadmap has been provided by the PJ Nayak committee—legal changes to incorporate banks under the Companies Act and the repeal of bank nationalisation Acts, dissolution of government ownership, and setting up of a Bank Investment Company (BIC). The BIC will act as a safety valve and an institutional firewall between the government and bank managements. The process of appointments to top management needs to be professionalised initially through an interim Banks Board Bureau (BBB), and latter through the BIC. BBB was set up, with a mandate to recommend candidates for top-post in state-banks; effectiveness is debatable.

Another issue with the proposed merger is the possible creation of what is known as systematically important institutions, which are too big to fail. Indeed, the State Bank of India was categorised by RBI as a systemically important bank whose failure could trigger a situation of bank runs. If such large banks were to fail due to governance issues, it could impact the economy and bring down the whole financial sector. A similar situation was witnessed during the Global Financial Crisis following the collapse of Lehman Brothers in 2008, and no country can therefore afford the failure of a big bank. Historical evidence suggests that if such a situation were to arise, the sovereign will be forced to rescue such large banks. The sovereign guarantees at many times encourage reckless behaviour by banks and creates the problem of moral hazard. Therefore, governance reforms along with effective regulation are essential to curb such moral hazard behaviour. It would require RBI to identify systemically important financial institutions from the merged banks and subject them to higher capital requirements.

The proposed merger is a good starting point for reforming the Indian banking system, but must be followed by genuine governance reforms.

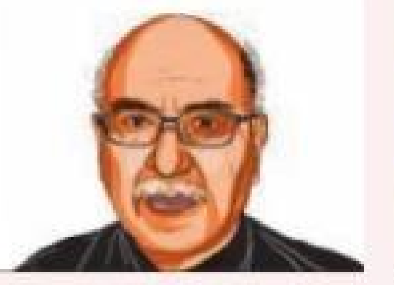
INCOME TAX DEPARTMENT

Efficient, but not really effective

Over the years, the department has been doing certain things right, but is it also doing the right things?

HARDAYAL SINGH

The author is ex-Chief Commissioner of Income Tax



THE MONTHS OF August and September have brought both good as well as bad news for the Income Tax Department. August started poorly. VG Siddhartha's suicide note suggested that the harassment that he faced from the department was one of the reasons for breaking his will to live. The department was quick to respond; officers who dealt with his case were only doing their duty when they attached the shares of Coffee Day Enterprises, the holding company of Café Coffee Day, the enormously successful café chain he founded. The mood in the industry lightened perceptibly when Prime Minister Narendra Modi, during his Independence Day address to the nation, signalled a policy shift by the government: Wealth creators, he pointed out, deserve our respect and encouragement. "A mind-set change is needed," finance minister Nirmala Sitharaman reiterated to tax officers a few days later.

More recently, in line with her policy of reducing interaction between tax officials and taxpayers, she announced a slew of administrative measures to allay the fears—to check misuse, from October 1 onwards, all tax notices, summons, etc, will be issued by the department through its centralised computer system. Taxpayers may disregard all notices issued otherwise. Actions pending under earlier notices are to be brought to a close by the end of September. Otherwise, they will have to be revived by a fresh notice to be issued centrally. New notices issued on or after October 1 must now be disposed off within three months. All these measures are in addition to schemes like making scrutiny assessments faceless without allowing any interaction between the department and taxpayers, and reducing litigation through liberalisation of income limits for filing of departmental appeals before the Income Tax Appellate Tribunal (ITAT), the high courts and the Supreme Court.

These events mask a complicated story, which is multidimensional and layered. At one level, the department goes about its business with a Bismarckian efficiency. This was reflected in the expeditious manner in which it attached the shares of Coffee Day Enterprises to protect its interests. It is also reflected in its performance data between 2000-01 and 2017-18, when its revenues grew from Rs 68,305 crore to Rs 10,02,741 crore at an impressive rate of 17.12% per annum. During this period, the cost of collection decreased by 55.15% from 1.36% to 0.61% of net revenues, and the direct tax to GDP ratio improved from 3.25% to 5.98%. Over the last five years of this period, return filers have almost doubled from 3.8 crore to 6.85 crore, at an impressive annual rate of 15.9%.

Statistics between 2011 and 2018 reveal another heartening fact; some regions, not known to generate large revenues—Jharkhand, Madhya Pradesh, Rajasthan, Kerala, Chhattisgarh, Haryana, amongst others—outperformed the national rate of revenue growth.

Altogether, within a certain framework, the department's performance has been impressive. This could not have been possible without rigorous monitoring. The department certainly did do certain things right. However, the question, in the context of Siddhartha and other complaints of harassment, is whether it also did the right things? Its performance must be judged in terms of not only its operational efficiency, but also by the extent to which it achieved its policy objectives.

Its raison d'être is assessment and collection of tax, according to law, at the lowest possible cost to the taxpayer and the exchequer. At the end of FY18, arrears of tax due to it were Rs 11,14,182 crore, 111.11% of the net annual collections of Rs 10,02,741 crore! And Rs 9,61,472 crore (or 86.29%) of these arrears were locked up in appeals before various appellate authorities. Past studies show that the department's success rate in appellate cases before the ITAT, the Supreme Court and the high courts is usually less than 30%, and sometimes as low as 13%.

Together, these numbers suggest taxpayers have to suffer huge, unsustainable additions, and then wait for years before their grievances are redressed. The costs they incur—in terms of time, money and energy—to comply with the law and pursue appeals are much higher than in other tax jurisdictions; understandably, they are also a cause of considerable harassment. The department can thus hardly be said to be collecting taxes according to law. Cost of collection to the government may be internationally competitive, but the costs to the society are extremely high.

PM Modi, in a sense, took note of this sense of disappointment—articulated by many business leaders on Siddhartha's suicide—during his Independence Day address. The reforms recently announced by the finance minister are all designed to align the department to its original purpose and improve its effectiveness to realise policy objectives. All taxpayers will hope that she succeeds. Apart from induction of technology and process simplification on which the department has been relying so far, training for generating behavioural change may also help.