# When the regulator is the violator

## Obedience of court rulings vital for ease of doing business

**WITHOUT CONTEMPT**

SOMASEKHAR SUNDARESAN

The Securities Appellate Tribunal has ruled that a minor cannot be held liable for not making an open offer under the takeover regulations. This is not a unique juvenile justice moment in the securities market. The tribunal simply reminded the Securities and Exchange Board of India (Sebi) of the law declared by the Supreme Court in another case involving securities regulation, and reiterated that the Sebi must not act against minors in whose names majors would have engaged in securities transactions and not complied with attendant obligations.

The tragedy in the case is that the Supreme Court ruling had been rendered way back in 2008. The court had ruled that a minor who is incapable under law to contract cannot be held liable for violation of securities regulations governing public issue of securities. Yet, nearly a decade later, in 2017, the Sebi issued a show-cause notice to another minor — this time for alleged violation of the takeover regulations. That tells a story of judicial indiscipline — of not adhering to the law declared by the last court of the land.

Courts in India are liberal when faced with breach of judicial discipline. Judgements tend to use verbiage in being critical and in issuing strictures to scold lower courts and regulatory authorities who violate judicial discipline by not following the precedents and the law declared by higher courts. Rarely does that translate into anything of consequence for a serious disincentive to the authorities below to ignore the law declared by higher courts. Some judges impose costs on state agencies, while other judges tend to promptly admit challenges when a state agency has been visited with costs. In any case, there is no metric to measure insubordination of judicial rulings, in the course of performance appraisal of regulatory officials. In fact, most senior management of regulators do not have performance appraisal at all.

Regulatory authorities — themselves mini-states with legislative, executive and quasi-judicial power all rolled into one — tend to be the worst offenders when it comes to judicial indiscipline. Despite the law being declared by courts, trenchant judicial indiscipline abound. A simple example is the denial of inspection of the record to a person accused of violating the regulations. Courts have time and again ruled that full inspection of the material on record — not just material used to level the accusations but also material that would undermine the allegations — must be provided.

When a regulator accuses you of violating the law, the regulator must not just tell you what it has against you, but must also give you access to all the material so that you are able to use it to undermine the accusations. If one can show that the material available with the regulator would lead no reasonable man to concluding that there is a violation, that is the process by which the truth is arrived at. Yet, in practice, even in this day and age, a clear and fair inspection of the entire record continues to be denied.

On a case by case basis, depending on the degree of aggression or timidity of the person accused of violation, courts have to be approached to get access to the basic material on record during an inspection process. A sweeping rejection of any request for inspection remains par for the course. A stellar exception to the rule is the Competition Commission of India, which has even codified a standard operating procedure for conducting a file inspection. Other regulators, such as the capital market regulator, are known to demonstrate an arbitrary variance in the approach of different officers and different whole-time members in how they would enable inspection.

When courts are approached, the regulator is prone to argue that the investigation material entails a lot of confidential information that cannot be shared. Courts could then direct that the report be provided with “sensitive” portions being blanked out. In one instance it so transpired that the same investigation report was inspected in two parallel proceedings only to find that the report that was provided in one of the proceedings had blanked out every finding of exoneration by the investigation team.

Likewise, despite superior courts having clearly declared the law, the authority below can keep reiterating its stance, blithely arguing that the decision has been appealed against. The Supreme Court has often ruled that such an approach is abhorrent, but with no one having to face any consequence for unleashing such chaos, the rulings remain mere exhortations. When the law is declared by a higher court with its interpretation, society is entitled to arrange its affairs in a manner that is consistent with known compliance. Yet, when regulators violate the interpretation laid down by the superior courts, society gets fearful — not of the law but of the law enforcer.

The Ease of Doing Business rankings can never model for this kind of unease with conduct of business in any jurisdiction. It is only when state agencies see value in the rule of law that they would be able to attract real investment into business without having to tout the rankings that a statistical model throws up.

*The author is an advocate and independent counsel. Tweets @SomasekharS*

## CHINESE WHISPERS

### Ring-fencing Priyanka?

Given the sad state of its organisational structure in Uttar Pradesh and the evident factionalism, even the most diehard Congressmen seem despondent about the party's chances in the bypolls to the 11 Assembly seats scheduled for next month. Interestingly, senior Congress leaders have already started the process of ring-fencing the party's general secretary in-charge of eastern UP, Priyanka Gandhi Vadra (*pictured*), from any negative publicity following expected poll reverses. They have refuted the possibility of Priyanka campaigning for these polls, saying "national" leaders do not canvass for "local" elections. This, however, stands in contradiction to her spirited sit-in to highlight the Sonbhadra massacre case and her much publicised statement that she would continue to highlight people's issues under the "anti-people" and "anti-poor" Adityanath dispensation.

### War of words

The Bharatiya Janata Party (BJP) was upbeat after Delhi Chief Minister Arvind Kejriwal on Wednesday said BJP state unit chief Manoj Tiwari will be the first to leave the national capital if the National Register of Citizens (NRC) is implemented in Delhi. Tiwari, a second-term Lok Sabha member from Delhi, hit back saying the remark exposed Kejriwal's "real face" and alleged that the Aam Aadmi Party (AAP) chief wants to evict migrants such as 'purvanchalis'. The term 'purvanchalis' denotes people from eastern Uttar Pradesh and Bihar, and over the last couple of decades they've become a significant part of Delhi's electorate. Tiwari, a Bhojpuri actor and singer, alleged that Kejriwal "wants to remove people from Bengal, Punjab, Madhya Pradesh, Haryana and other states in Delhi". Assembly elections are due in Delhi in February. Meanwhile, the Congress continued to struggle to pick its state unit chief. With Ajay Maken ruling himself out, speculation is former Lok Sabha member Sandeep Dikshit could be in contention. Dikshit, son of Sheila Dikshit, met Congress President Sonia Gandhi on Wednesday.

### Will he, won't he

The Congress has planned *padyatras* across the country on October 2 to mark the birth anniversary of Mahatma Gandhi. Congress leader Rahul Gandhi, who has kept himself away from political work after the Lok Sabha poll debacle, is likely to be in Maharashtra's Wardha to lead the *padyatra*. The Mahatma set up his ashram in Sevagram, a village in Wardha, in 1936 and remained there until his death. There was apprehension in the Congress that Rahul Gandhi might not campaign for the party at all for the upcoming Assembly polls in Maharashtra and Haryana. However, his decision to lead the *padyatra* has made leaders hopeful that he might decide to begin his election campaign with the *padyatra*.

# External benchmarks: A tough one for banks

## The RBI's diktat on retail and MSME loans adds a layer of complexity

JOYDEEP GHOSH

The Reserve Bank of India's (RBI's) decision to link all floating rate retail loans and micro, small and medium-scale enterprises (MSMEs) from October 1 comes after several attempts in the past — from prime lending rate to marginal cost of funds (MCLR) — to ensure smooth transmission of interest rates cuts failed. Now, all banks have to link the lending rates to one of these four — the RBI policy repo rate, government of India three- or six-month Treasury bill yields or any other benchmark market interest rate published by the Financial Benchmarks India (FBIL). How workable is this proposal?

**TAKE TWO**
ANALYSIS BEHIND THE HEADLINES

Says Madan Sabnavis, chief economist, Care Ratings: “From a regulatory perspective it is an ideal way to ensure that transmission of repo rate changes takes place on the lending side. However, there was an anomaly the last time when the RBI lowered the repo rate to 5.4 per cent. One indicator, the 10-year Government Security (G-Sec), if it had been used as a benchmark, would have gone contrary to the direction of the repo rate change as it has increased over the two month period by 20-30 basis points (bps).”

Sabnavi says banks are likely to face a tough time from a commercial banking perspective as they have to benchmark a part of their assets to an anchor while not being allowed to do so on the liabilities' side. Rating agency Moody's Investor Services has already warned that the move would be credit negative for banks, causing volatility in net interest margins (NIMs). “With NIMs rising when interest rates rise and falling when rates fall, the move will translate into volatility in the overall profitability of banks. It is not clear if banks will be able to mitigate this risk by linking the interest rates on current account, savings account (or CASA) deposits to an external benchmark. With interest rates already low on these deposits, a bank is unlikely to want them any lower as it will risk losing customers.”

Former RBI Deputy Governor and Chairperson of FBIL, Usha Thorat says: “Currently, banks price loans based largely on the cost of their deposits. CASA constitutes about 40 per cent of their liabilities and are not interest rate sensitive. Fixed deposits constitute about 50-70 per cent. The average maturity of these deposits is between one year and 18 months. Hence, to manage their asset-liability management (ALM), banks prefer to link loan rates to their deposit rates on fixed deposits to keep their NIM stable.”

According to Thorat, the one-year deposit rates of banks is closely correlated to some FBIL benchmarks – the 364-day T Bill rate or one-year G-Sec yield or even the one-year OIS (overnight index swap) rate. “Hence, banks could link their floating rate loans to an appropriate one-year benchmark to manage the asset-liability mismatch. The three-month reset specified by the RBI could, however, pose challenges and it may be better to leave the choice of reset to the individual banks. Some banks may have concentration of liabilities in the five-year segment and may prefer to reset their floating rate interests at longer intervals — as, I believe, State Bank of India (SBI) is asking for,” Thorat adds.

**The backstory**

In fact, the implementation of this rule has been delayed by a good six months. In December 2018, under former RBI Governor Urjit Patel, it had been mandated that the shift would take place from April 1, 2019. The decision came after a rather damning report by the central bank's internal committee led by Janak Raj. The committee studied four major banks (two public and two private) and found that one major public sector bank decided on the MCLR rate, based on card rates of retail term deposits of seven days to one year. It fully ignored the cheaper resources collected under CASA. In the case of private banks, some even flouted apex bank guidelines by having multiple rates instead of one MCLR across products. This was done by using different operating costs for different loan products.

**STANDARD DEVIATIONS**

**(Why banks could find external benchmarking a challenge)**

- Contrarian rate fluctuations of benchmarked instruments
- Asset-liability mismatch Competition will force banks not to lower deposit rates
- Volatility in net interest margins
- Three-month reset and three-year benchmark lock-in could restrict banks' flexibility

Patel's abrupt resignation came as a partial relief for banks. In April's Monetary Policy, the central bank stated that “further consultations will be held with stakeholders to work out an effective mechanism for transmission of rates”.

Then came the economic slowdown. And the Finance Minister and Prime Minister started asking banks to pass on rate cut benefits. After all, since Shaktikanta Das took over in January, the repo rate had been cut by 110 basis points. But there were not significant cuts from banks. The RBI finally bit the bullet earlier this month.

**The way forward**

One of the key changes that banks may have to make is how they price their deposits. Floating rate deposit rates are ideal, but with rates on some products of National Savings Schemes as high as 8.6 (Sukanya Samridhi Yojana), they fear losing depositors in bank fixed deposits.

The State Bank of India and 14 other public sector banks have already announced products linked to the repo rate. In the SBI's home loan product, the loan amount will be divided equally across the tenure, and the equated monthly instalment will be high initially and reduce as the number of years increase.

But the key would be spreads. “It will be an interesting development for banks as they have to carefully choose their spreads over the chosen benchmark as this cannot change for three years,” says Sabnavis.

He offers an example. If on October 1, a bank benchmarks home loans to, say, 200 bps over the repo rate of 5.4 per cent, the basic lending rate would be 7.4 per cent. Now, in the first week of October, if the RBI lowers the rate by 25 bps, the lending rate would automatically come down to 7.15 per cent and there would be a hit on the books. “Therefore, arriving at the right spread to protect the profit and loss account will be critical for banks and they also have to anticipate how many more rate cuts would be there during the year while fixing the same,” adds Sabnavis.

In other words, the Indian banking business just got more complex.

**INSIGHT**

# Reform and Modi's gift of timing

DHIRAJ NAYAR

There is a pattern in Prime Minister Narendra Modi, the reformer. And there is a method. Only the truly naïve would believe that economics and not politics would come first for the most talented and successful Indian politician in several decades. The Prime Minister has the right instincts on economics. His long track record in Gujarat and his speeches since he became the prime ministerial candidate of the BJP in 2013 lay out his vision quite clearly: Get the government out of areas where it is a hindrance, in business activity for example and strengthen government in spheres where it needs to deliver, in welfare for example. A vision is not, and cannot be, entirely implemented in one quarter or even four, not in a complex democracy with competing interests. When the history of his rise and tenure in government is written, perhaps what will stand out is Modi's genius in timing.

Those who have observed Modi's track record should not be surprised that he has started his second term in office as PM with two big bangs — the abrogation of Article 370 and a deep cut in corporate tax rates. Contrast these four months with the corresponding four months in 2014. Then, the biggest bang was the announcement to abolish the Planning Commission — not unimportant but not big bang. Like his first full term as CM of Gujarat, Modi's first term as PM of India was about learning and consolidation of political power. It's in the second term that he pushes the accelerator. Hence his description of what has happened so far as only a trailer of the presumably action-packed film to follow.

Cut back to the first term. Modi did take a step towards what could be called big bang reform when he tried to amend UPA's awfully restrictive land acquisition law. He took flak for stepping back when Rahul Gandhi targeted him with the “suit-boot” jibe. A canny politician, Modi would have been acutely aware that one of the reasons for the defeat of the only previous BJP-led government was because the Opposition had successfully painted it as a pro-business and pro-rich government because of its liberal economic policies. Remember also, that in 2014-15, the public perception of India's private sector was dominated by crony capitalism. Politically, the timing was not right for aggressive market reform.

For the rest of his first term, Modi followed a two-pronged approach to economic policy. First, to decisively act against crony capitalism, black money and corruption in order to shore up the legitimacy of a private sector-led economy. And second, to ensure efficient delivery of welfare to the most marginalised so that they became active stakeholders and supporters of his broader vision to change India. The latter is now viewed by conventional wisdom as one of the main reasons he won an even bigger majority in 2019. The former is often criticised for the disruption it caused to the economy (whether demonetisation or GST or the Insolvency and Bankruptcy Code) — and indeed the administrative machinery could have done a much better job of implementation — but without it the deep corporate tax rate cut, which is a fundamental structural reform of the economy, would never have seen the light of day.

Critics of the Modi government are wrong when they say that the economic slowdown has been caused by this government. The truth is that the slowdown began in 2011-12 by when the dividends of the Rao/Vajpayee reforms had greatly diminished and the consequences of a sustained global slowdown became apparent. The lack of substantive reform between 2004 and 2011 was biting and the nasty side effects of almost double-digit growth in the form of corruption and cronyism was causing a fever.

Modi's disruptions did not aid growth — a simpler GST might have — but they played their part in cleansing the economy and changing public perceptions. Now, the jibe of suit-boot will not stick. The bold corporate tax reforms can be followed with other structural reforms like the privatisation of public sector companies. Again, there will be a method. Air India, the sickest PSU may be offloaded first. Some of the more profitable PSUs, like in the oil and resources sector, may be divested by reducing the government's stake to 49 per cent while having a diversified public ownership for the remainder. Land and labour reform will come, but given the politics, it may come in the form of pilot experiments in some BJP-ruled states.

Of course, welfare is not going to disappear. It should not. Market reforms can only succeed if the system is perceived as fair. Modi may yet succeed at doing what no Indian PM has before — subsuming good economics into successful politics but not by textbook and in his own time.

*The author is chief economist, Vedanta*

## LETTERS

### Bold move

Finance Minister Nirmala Sitharaman (*pictured*) deserves to be congratulated for the two significant tax reforms recently. The first one being slashing of corporate tax from 30 per cent to 22 per cent that will enthuse the industrial community to bring in capital investment. The second being the most unique tax reform, never heard of in any economy in the world — that is, any new company desirous of starting a new business after October 1, 2019, and commencing production before March 2023, will pay only 15 per cent corporate tax. This will certainly give a boost to any new entrepreneur to set up a new unit and avail of the tax benefits. This major tax incentive is likely to attract foreign investors to invest in new ventures in India. In fact, Petronet LNG has already evinced interest with a strategic investment of $2.15 billion in Tellurian US LNG. There has been a significant rise in the share market as well.

The finance minister definitely deserves to be complimented for her bold and innovative tax reforms in the country that will certainly revive the economy and spur growth in the remaining quarters of this fiscal year.

**Satish Murdeshwar** Pune

### Lessons from Britain

The UK Supreme Court has shown that it can rule independent of the interest of the government of the day, something judiciaries in other democracies can emulate. Its unanimous ruling that the prorogation of the British Parliament by Prime Minister Boris Johnson was unlawful, upheld the Parliament's sovereignty and its supremacy over the government.

It was a ruling that is relevant and applicable to our own country as its Parliament is modelled on the British system. The UK top court made it clear that if the ruling vindicated the opposition's stand on the prorogation of the Parliament and benefitted it in the political tussle to get the upper hand, it was only incidental to its establishing the illegality of the prorogation.

The real intent for prorogation was to stymie parliamentary scrutiny at the crucial stage of negotiations of the deal for Brexit. Despite a string of political and legal setbacks like losing parliamentary majority and receiving court strictures for preventing the Parliament from doing its job and attracting the charge of stifling democracy, Johnson declared that the ruling — with which he strongly disagreed and termed a serious mistake — would not deter him from delivering Brexit on the October 31 deadline.

There is now considerable uncertainty over Brexit. The Labour Party's stand is that Johnson has no mandate for a no-deal Brexit and the crisis can be settled only by a general election. London must get an extension from Brussels to avert the risk of its crashing out of EU without a deal.

**G David Milton** Maruthancode

### Competition is good

Your editorial, "The private train mirage" (September 25), does well to point out the pitfalls in the proposal to introduce privately-run trains under the overall scheme of public private partnerships. But permit me to disagree with your thinking that the “idea is fundamentally flawed”. I think it is a brilliant idea that deserves serious consideration. Time has come for such out-of-the-box thinking if we want to modernise rail travel in India.

Of course, you have made a crucial point when you talk about the need to reform Indian Railways and the Railway Board. The two will definitely need to be separated, their umbilical cord has to be cut. The Railway Board must assume the role of a regulator and allow both the Indian Railways and the private companies to run trains on a level playing field. That done, there should be no problem allowing private sector entry in this important public mobility sector. Just because of the need for this major reform, let's not throw the baby out with the bath water.

Public and private companies have coexisted in power, telecommunications, mining, aviation and other sectors. Why not in rail travel? Competition will do good to the sector.

**Krishan Kalra** Gurugram

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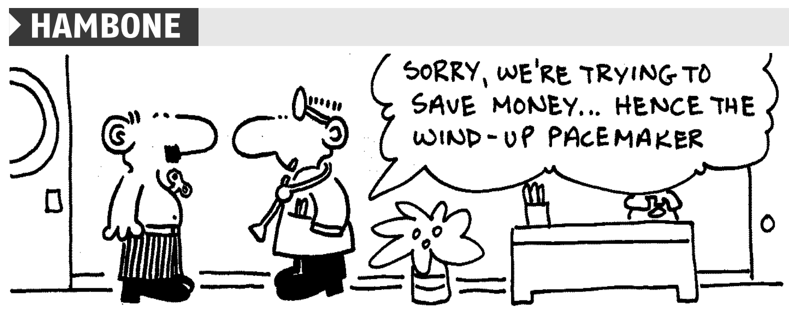
**HAMBONE**



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## Strengthen cooperative banks

### RBI and govt should not waste the PMC crisis

The Reserve Bank of India (RBI) on Tuesday placed the Punjab and Maharashtra Co-operative Bank (PMC) under "directions". Consequently, cash withdrawals have been capped at ₹1,000 per account for six months, and the bank will not be able to extend credit, take fresh deposits or make any payment. Predictably, the decision has resulted in panic among depositors. While the details on why the banking regulator was forced to put such restrictions are still sketchy, the issue is reportedly related to the bank's exposure to Housing Development & Infrastructure (HDIL). The company has been admitted by the National Company Law Tribunal for insolvency proceedings, though it has been challenged by the realty firm. There are differences between the auditor and the regulator in terms of treatment of loans extended to HDIL. There could also be issues related to governance as the bank and HDIL have had links in the past. The collapse of PMC appears to have been sudden and is shrouded in mystery, and things will become clear once the regulator completes the examination. At the end of the last financial year, PMC declared a net profit of about ₹100 crore with deposits over ₹11,000 crore. At the net level, non-performing asset was at a modest 2.19 per cent.

The regulator and the government would do well to re-evaluate the importance of cooperative banks in the current financial landscape to avoid recurrence of such an incident. According to the RBI, at the end of the last financial year, India had a total of 1,542 urban cooperative banks, of which 26 were under directions of the regulator and 46 had a negative net worth. There have been delays in adoption of core banking solution in some cases because of a lack of expertise and capital. Governance is a real issue in many of these banks. It doesn't help that they are regulated by both the RBI and the Registrar of Cooperative Societies of the state concerned. Further, there are issues related to capital. Urban cooperative banks cannot raise capital through a public issue or issue shares at a premium. They also face difficulties in meeting short-term liquidity requirement because not all can directly access RBI's liquidity support. Cooperative banks fail often because of their small capital base — for example, urban cooperative banks can start with a capital base of ₹25 lakh compared to ₹100 crore for small finance banks. Also, such banks are hijacked by vested political interests.

To be sure, cooperative banks played an important role in the past, including in the colonial period, but their relevance has declined with the spread of scheduled commercial banks and adoption of technology in recent years. Given their lack of expertise and capital, it will be difficult for these banks to compete with other financial institutions. Therefore, it is important to carry out a comprehensive review and make changes in the law to give more power to the RBI in terms of regulation, mergers, and conversion of some entities into commercial or small finance banks. This will allow them to raise capital and attract talent. In the absence of policy initiatives, these banks would increasingly become more vulnerable.

## The balancing act

### Privacy on social media must be protected

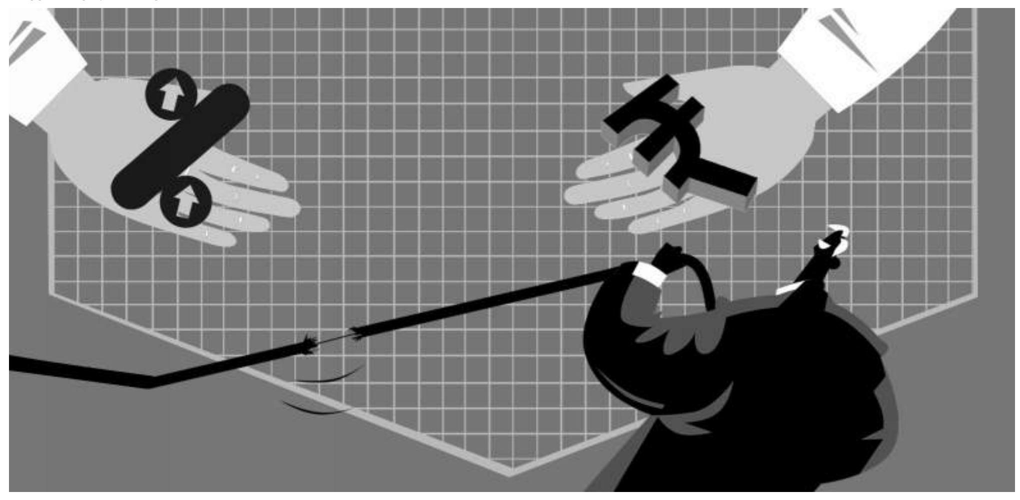
A two-member bench of the Supreme Court on Tuesday asked the Centre to frame rules for the moderation of social media and to file an affidavit detailing the same within three weeks. The observation was in connection with the transfer of various cases pertaining to the linking of Aadhaar with social media accounts. In effect, this would imply that the identity of every Indian social media user would be available to the government. Even otherwise, the government had been attempting to force major social media platforms to provide methods for content to be traced to the originating accounts.

While the court directed the government to maintain a balance between impinging on the privacy of individuals using social media and offering redress to victims of trolling, it is hard to see how this would be possible under the existing technology. If the option of anonymity is removed, so is privacy, since social media content is, by its very nature, public, or at least visible to many people. Social media accounts are indeed often used to troll individuals. These platforms can also be employed for the rapid dissemination of fake news and damaging rumours. The flip-side of the story is that social media is a powerful tool for whistle blowers and it has often been the channel by which criminal activity has been first uncovered, or brought to public notice. Countless individuals, corporations, civil servants and politicians have been embarrassed by revelations of their wrongdoing on social media.

It is also a powerful platform for expressing dissenting political opinions, and coordinating protests against unjust laws. Every mass movement of the last decade, from the first Arab Spring protests in Tunisia, to the recent protests in Hong Kong and the ongoing battle against climate change, has been enabled by the existence of social media. All this would not have been possible without the capacity of social media users to remain anonymous and yet be heard. Indeed, the protests in Hong Kong have featured a fascinating technological battle between protesters striving to maintain anonymity and a regime doing whatever it can to uncover the identity of activists. Every undemocratic regime in the world would like social media to lose its veil of privacy. Many have banned platforms that allow for privacy precisely due to fears that these may be used to express dissent, or throw a light on repressive actions. India, for example, has faced flak for shutting down the Internet in Kashmir, with activists alleging that this gives security forces a free hand to indulge in abuse and excessive use of force.

It may be argued that the benefits to society from protecting the privacy of individuals using social media far exceed the ills that arise from the dissemination of fake news. Moreover, privacy is a fundamental right as the Supreme Court affirmed two years ago. There are legitimate fears that any regulation that the government frames in haste will be flawed, or applied selectively, to harass political opposition. Until specific legislation that defends the fundamental right to privacy is written into law, anything that impinges on that right should not occur. Trolling and the spread of fake news can be contained and committed under existing regulations by the use of sensible policing.

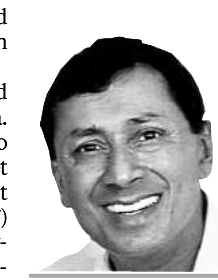
ILLUSTRATION: BINAY SINHA



# Economic shudders & revival strategies

### Discarding attention-grabbing slogans, the government needs to aim for real GDP growth of 8 per cent and higher

The central government ought to be red-faced about the 5 per cent GDP growth rate for the first quarter of 2019-20. In 2014, the Bharatiya Janata Party-led government had inherited public sector banks (PSBs) weighed down with non-performing assets. On the positive side, international oil prices have been at relative lows and domestic inflation has been muted for the past few years. Partisan supporters of the government explain away the slowdown through unsolicited Whatsapp messages, which gush that India's 5 per cent growth is high compared to growth rates in developed countries. Such growth rate comparisons with G7 countries are irrelevant as most Indians do not have access to the social, health and unemployment benefits provided in developed countries.



JAIMINI BHAGWATI

The stark reality is that rural and urban demand has slumped in India. Among many factors this is due to what I would call a triple balance sheet problem. The twin balance sheet problem (Economic Survey 2016-17) afflicting major private sector borrowers and lenders was caused by irresponsibly high loan disbursals during 2008-12. The third balance sheet belongs to those who purchase cars, scooters, consumer goods and services using their credit/debit cards for payment through equated monthly instalments (EMIs). Many among these demand groups are unwilling to increase their EMI payments because earnings shocks caused by demonetisation and slower than expected disbursal of GST refunds have persisted.

An important factor constraining foreign demand for Indian products has been the significant overvaluation of the rupee. On September 19, 2019, the RBI governor citing a July 2019 IMF report commented that the rupee's real effective exchange rate (REER) is close to its correct value. An RBI report again dated July 2019 mentions that the rupee's REER is overvalued by 24.6 per cent against a basket of six currencies. It is strange that the RBI governor prefers to quote the IMF report on the rupee exchange rate.

Higher lending by Indian banks and non-banking finance companies (NBFCs) would help revive domestic demand. However, Indian financial institutions are hesitant to push up lending. Lenders are circumspect because defaulting borrowers are managing to retain assets pledged as collateral at the time of borrowing, although others have bid for such assets through transparent processes. The February 12, 2018, RBI circular had prescribed that lenders have to recognise default as soon as it happens and borrowers had 180 days to resolve matters with lenders before the latter were obliged to take the matter to a National Company Law Tribunal (NCLT). Borrowers need to be in touch with lenders well before default happens to extend repayment deadlines or look for bridge loans from other sources. In this context, the quashing of the February RBI circular by the Supreme Court on April 2, 2019, was a monumental blunder. The RBI and government should have jointly pleaded in support of this circular. Apologists for recalcitrant borrowers suggest that they be allowed to retain their assets and helped by lenders to recover. Limited liability legislation allows promoters to retain personal wealth and only what was pledged can be attached by lenders.

The government seems to have reverted to expecting PSBs to show infinite patience and in practice this often results in collusion with large borrowers. The remedies go back to proposals including one made by the Banks Board Bureau for board members of public sector banks to be chosen for their domain knowledge and unimpeachable integrity. Additionally, speedier resolution of cases pending with NCLT is needed. At this stage it appears as if the Insolvency and Bankruptcy Code and Insolvency and Bankruptcy Board of India may become irrelevant much in the same way as the SARFAESI Act of 2002 and corresponding debt tribunals.

Government could raise resources, from foreign and domestic sources, by reducing its equity holdings in LIC and Coal India to around 60 per cent. Air India, MTNL and BSNL continue to suck up resources and it is high time the government reduced its equity shares in these entities, preferably by attracting foreign investment. If funds are accessed only from domestic sources, financing support could be drawn away from other local investments.

On September 20, 2019, government announced significant reductions in corporate tax rates. This measure could boost demand but with a lag if companies pass on higher retained earnings to employees and reduce prices. Domestic and foreign investments could increase over time if the lower tax rates are competitive in comparison to alternative investment destinations. The downside though is immediate since government may lose up to about ₹1.4 trillion ($20 billion) of revenue during 2019-20, and the centre's fiscal deficit could rise well over 4 per cent of GDP leading to higher interest rates. The GST Council has done its bit to revive "animal spirits" and has reduced GST rates on hotel accommodation and that should have a positive impact on tourism.

In the first four months of 2019-20, about $5.8 billion left India under the liberalised remittance scheme (LRS), and during 2014-19 the total amount remitted abroad amounted to $45 billion. The comparable amount for 2009-14 was much lower at $5.5 billion. By contrast, inward foreign direct investment has risen and amounted to $42 billion in 2018, according to UNCTAD's World Investment Report 2019. However, the sizeable LRS outward remittances should be a matter of concern.

To conclude, there is an unreal air to the way government has harped about a $5 trillion Indian economy by 2024, which diverts attention from the urgent need to raise domestic and foreign demand for Indian goods and services. A few months back a senior Ministry of Finance official demonstrated his lack of understanding by suggesting that if the Indian rupee were to appreciate, India could easily reach the $5 trillion goal. Discarding attention-grabbing slogans government needs to aim for *real* GDP growth of 8 per cent and higher annually in rupee terms, which is a tried and tested way for India to raise employment and reduce poverty.

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# Economic recovery will be slow in coming

The cut in the corporate tax rate is seen as the boldest of the barrage of measures unleashed by Finance Minister Nirmala Sitharaman. It has sent the stock market soaring. There are expectations that an internationally competitive corporate tax rate will boost investment in the economy, both foreign and domestic, and lead to a massive creation of jobs and incomes. Such expectations need to be tempered by a dash of realism.

Let's take foreign direct investment (FDI) first. There is little to suggest that FDI has been held back by the higher tax rate that obtained thus far. Gross FDI flows into India rose from $28 billion in 2013 to $42 billion in 2018, according to UNCTAD's World Investment Report, 2019, despite India's tax rate being uncompetitive.

FINGER ON THE PULSE

T T RAM MOHAN

More crucially, the bigger chunk of FDI flows in the world, 63 per cent of the total, tends to be in the form of mergers or acquisitions (brownfield investment) rather than greenfield investment. It's greenfield investment, not the brownfield variety, that can provide a big impetus to jobs and incomes. In India, brownfield investment is even more dominant than in the world as a whole: In 2018, it constituted 78 per cent of total FDI. The idea that, following the tax cut, a wave of FDI will dramatically lift jobs and incomes is rather misplaced.

The cut in the corporate tax rate will enhance domestic corporate savings and could lead on to higher investment. Analysts have pointed out that the accretion to domestic corporate saving will be less dramatic than the headline numbers suggest. In effective terms, the tax rate goes down by only four percentage points.

Even on this account, any increase in investment will happen only over the long run. In the short run, Indian firms are unlikely to step up investment significantly for several reasons. One, private consumption is faltering. Two, banks will be wary of increasing exposure to corporate groups with whom they still have to resolve bad loans. Three, despite announcements of infusion of capital, many public sector banks lack capital to increase lending significantly. At least for a year or two, corporate investment will be clouded by uncertainty.

The one thing that is certain is that the fiscal deficit will end up higher than the target 3.3 per cent for 2019-20 — perhaps closer to 3.8 per cent after factoring in various other effects including the RBI's transfer of surplus. The finance minister has dispelled any expectation that the estimated revenue loss would be offset by a cut in government spending. Analysts who were cheering the government for announcing sector-specific measures while refraining from providing any fiscal stimulus will be disappointed.

The government clearly believes that the slowdown is serious enough to warrant a fiscal stimulus in addition to the ongoing monetary stimulus. The question is whether the cut in the corporate tax rate is the best way of providing a fiscal stimulus at this point. Why not through an increase in government capital expenditure? Perhaps this does not fit in with the government's thinking, reflected in the last Economic Survey, that private investment alone can be the primary driver of growth. The government may also have felt that public capital expenditure would not crowd in private investment in a situation where corporations are constrained by high debt-to-equity ratios.

An increase in the fiscal deficit limits the potential for rate cuts by the RBI in the months ahead. The government may well have reckoned that the cuts in the policy rate have gone far enough. The issue now is one of transmission of policy rates and the creditworthiness of firms. Any increase in government bond yields on account of a higher fiscal deficit could be contained through a modest sovereign bond issue.

The sector-specific measures announced in instalments earlier are a mixed bag. Some of these (such as the mergers of public sector banks) are of little relevance to the present slowdown. Others (such as timely refunds of GST to MSMEs and expediting payments due to them from the government) will help if implemented rigorously. The measures to boost exports are among the most promising. The special fund for last-mile funding for certain categories of housing projects will not make much of a dent on the large number of unfinished housing projects.

The critical issue is the disruption of credit hitherto provided by non-banking finance companies (NBFCs). The government has proposed that public sector banks (PSBs) co-originate loans with NBFCs. One is not sure how this will work on the ground. NBFCs can pass on potential clients to PSBs for a fee. This will ensure flow of credit to particular segments but it does little to improve the financial health of NBFCs. A better option is for PSBs and NBFCs to co-finance loans. This will ensure flow of credit while also improving the health of NBFCs. But PSBs have no incentive to opt for this course except in cases where they have exposures to NBFCs.

Neither the tax cut nor the sector-specific measures will change the near-term growth outlook dramatically. Indian firms, especially small firms, are going through a process of considerable adjustment consequent to demonetisation and the introduction of GST. Bad loans in the banking system declined in 2018-19 but remain at a high level of over 9.3 per cent of advances. Global growth has decelerated. The Seventh Pay Commission booster to consumption tapered off in 2018-19. The substantive effect of the measures announced may well be that it improves business and market sentiment and sets the stage for strong growth further down the road.

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# The journalist & the *jihadi* conman

BOOK REVIEW

VIKRAM JOHRI

In the book under review, Shiv Malik, a corporate communications professional and former investigative journalist, recounts the unnerving tale of being conned by a man who claimed to be an Islamist sympathiser with links to terror organisations.

After the 7/7 bombings in London, the British media was keen to probe homegrown terror emanating from Muslims born and brought up in Britain turning to Islamist ideology. Malik, who has worked for a number of British media outlets over the years, was keen to interview Hassan Butt, an Al Qaeda-affiliated radical, who as early as 2002 had claimed that he had recruited British volunteers to fight for the Taliban.

The book brings out the story of their association. In their first meeting, Mr Butt claimed to have met Mohammad Sidique Khan, the leader of the group that planned and executed the July 2005 bombings. Mr Malik visited Mr Butt's house in Manchester, a spartan residence that seemed to agree with the strict Islamist doctrine that he espoused.

The journalist-source relationship changed into something less formal as the meetings progressed. Mr Malik learnt of Butt's family, his strained relationship with his father, and the constant need for financial security. Since both men are South Asian, there were cultural similarities as well.

Six months into their association, Mr Malik received an email from Mr Butt saying that he wished to renounce Islamist ideology. He said that he had developed differences with other ideologues and that he had stopped receiving funds from them. In response, Mr Malik floated to Mr Butt the idea of writing a book that would narrate his disenchantment with Islamism. He agreed.

The turning point in the relationship came when news of the book's writing spread in the media and Mr Butt was attacked by an unidentified assailant who, he claimed, belonged to "the network", that is, Al Qaeda. Mr Malik became increasingly protective of Mr Butt, to the extent that when the police questioned him about the book and his association with Mr Butt, he refused to reveal anything and even went to court to protect his source.

Even as Mr Malik accommodated Mr Butt's increasingly wayward demands, the rest of the story is a cautionary tale of how he felt deeper into the vortex of a fraud that ultimately unravelled in 2008 when the British anti-terror police arrested Mr Butt. On questioning, Mr Butt revealed that he had never had links with Al Qaeda or any other extremist organisation. Furthermore, he had arranged for himself to be stabbed to gain publicity and that the book with Mr Malik was his way of making money.

The question of how Mr Malik was taken in by Mr Butt's duplicity is not an easy one to answer. Towards the book's end, he presents evidence that Mr Butt may have been working for the MI5, Britain's spy agency, all along. The logic for this is offered by Mr Malik thus: Mr Butt and a clutch of other British-born radicals were reared by the MI5 to make clear the threat from homegrown terror.

From here, Mr Malik situates his dilemma in the current political climate and blames his gullibility on the rise of demagoguery. He presents the world today as reflecting a dialectical schism between the innocent and the un-innocent, with the former looking the other way as the state resorts to every means possible to question and tame the latter.

This is a rather disingenuous lesson to draw from the protracted, tragic episode. One, 7/7 was indeed planned and executed by homegrown terror, one in a series of similar attacks that took place in Europe over the years that followed. Two, Mr Butt may have played Mr Malik and others and may have been prompted by MI5 to do so, but the threat of Islamic terror remains a real danger.

Finally, Mr Malik's own interest in the book project stemmed from his desire to articulate the story of a reformed *jihadi*. A significant part of the book is devoted to how Mr Malik worked with Irshad Manji, the religious reformist, to rehabilitate Mr Butt. The fact that Mr Butt turned out to be a conman does not detract from the very real work being done in this regard and the need for such work to continue, regardless of Mr Malik's views on the invidiousness of the state and its apparatus.

Last year, Mr Butt was sentenced to 13 years in prison for perpetuating a £1 million fraud on unsuspecting eBay customers in 2014, an anticlimactic turn of events for someone who claimed to hobnob with Al Qaeda bigwigs. Meanwhile, Mr Malik has moved on from journalism. *The Messenger* is an engaging and disturbing tale of intellectual credulity that has deeper roots than the book's author would have us believe.

**THE MESSENGER**
Shiv Malik
Penguin Random House
₹599, 321 pages