Opinion

MONDAY, NOVEMBER 25, 2019

CRYING COUP

Prime minister of Israel Benjamin Netanyahu

It is an attempted coup based on fabrications and a tainted and biased investigative process. I will continue to lead the country, according to the letter of the law, with responsibility, devotion and concern

RationalExpectations

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Morality-play can't be good governance

PM right in saying CAG must evolve from just fault-finding,a but that requires government to start thinking differently

PRIME MINISTER NARENDRA Modi struck the right note when, at a conclave of the CAG on transforming audit, he spoke of how CAG needed to—apart from using digital tools and other innovative methods to catch fraud—think from the perspective of a think tank, not just from the point of view of an auditor whose primary job is to find faults. The CAG, he said, should adopt global best practices, and share experiences of other countries to help the government get more efficient; become a catalyst for good governance, as he put it.

While there could be opposite views on whether an auditor should even get into such issues, it is not clear if the CAG—or any other auditor for that matter—can even make this transition since this requires essentially different set of abilities. But, even if this is possible, it cannot possibly work until there is a complete change in the way the government thinks and operates; morality-play, to put it bluntly, has no role in such a system.

It is clear from the experience of both BSNL and ONGC, to mention just two names, that PSUs are losing out due to the lack of flexibility caused by L-1-*itis*, or the rule that mandates PSUs must have open tenders for most purchases/orders. So, if the CAG points out that L-1-*itis* is causing more harm than good and needs to be scrapped, or radically altered, will the government agree to it? Chances are, it won't. If it was so inclined, it would have, by now, amended Article 12 of the Constitution to remove PSUs from the ambit of 'instrumentality of state' that is the reason for L-1-*itis*. Indeed, even now, when the government is talking of lowering its stake in certain PSUs to below 51%, it is not clear if this is to free them from this constraint; while outlining the plan, in fact, the government usually talks of how the PSU character will not be affected!

> **While the govt, not just CAG/CBI/CVC focus on L-1 bids, no one bothers about the loss in market value caused by the L-1-*itis*. Sure, CAG needs to evolve as PM says, but when will govt focus on such issues instead of its obsession with just morality?**

When the Modi government came to power in 2014, the share of PSUs in the country's overall market-capitalisation was 22.5%, it is down to 8.4% today, or by around two-thirds; this means a notional loss in the value of PSUs of ₹21 lakh crore in the last 5+ years! Ideally, rather than worrying about just whether a PSU manager made money in wrongly awarding a contract—as both the government and the CAG do—this is what the government should be worrying about, and then finding solutions to it. If the renewed CAG—CAG+, to use Modi's term—were to point this out, would it make a difference and get the government to genuinely free PSUs from all shackles? Unlikely.

If the CAG report said—its performance audit is different from the routine one – that, for instance, most of the fertiliser subsidy is used by rich farmers, would the government scrap the system and move to cash transfers to all farmers? Or, if the CAG pointed out that the system of giving two-thirds of Indians highly-subsidised rations via the PDS cost around ₹50,000 crore more per year as compared to just giving them cash, would the government scrap the FCI-based system?

While the answer to both questions will probably be a 'no', the point is that fraud/theft is not just about one person taking money to do something, it is also about a system that causes a loss to the exchequer even without anyone taking money or seeking favours; a criminal-less crime, as it were!

Or, take the case of the CAG's 2G report that many influential people blamed the organisation for; the deteriorating financials of the telecom industry, many argued, was the result of the government starting to auction spectrum after the CAG report in 2010. The sky-high prices, actually, had nothing to do with the auction *per se*, but were the result of bad government policy like keeping spectrum supply short, arbitrarily keeping a high floor price, threatening to cancel licences if telcos weren't able to buy spectrum, etc. An even bigger problem was the government's mindset. Ideally, since it was charging for spectrum, it needed to scrap the licence/SUC fee, but it didn't do this for fear that it would have been accused of benefiting the telcos. Indeed, as this newspaper has said before, if this had been done in 2010, the AGR case the SC just ruled on would have had an impact of a few thousand crore, not ₹133,000 crore.

While the decision not to scrap licence/SUC fees in 2010 was a UPA decision—this government failed to fix things after it came to power in 2014—another example of morality-play is that of raising natural gas prices from \$4.2 per mmBtu to \$8.4; the UPA proposed this, but wasn't able to implement it before the 2014 elections. When the BJP won, it refused to implement what it felt was another UPA scam, never mind that it was importing gas at \$12-14 at that time. It was only after two years of not doing this, when investment in the sector dried up, that the BJP raised prices. In other words, the government's gas policy for two years—and the telecom policy even now—was that it doesn't matter if the decision hurt the country's interests, the public perception of the government's honesty mattered more.

Atal Bihari Vajpayee's NTP-1999 policy, to put this in perspective, had people alleging corruption too, but it is this policy that single-handedly drove India's mobile phone revolution and, within a few years, the government earned more licence fees than what its detractors said it had gifted to a few industrialists. There are several such examples that can be cited, but the point each one makes is the same: if morality, or the perception that you are incorruptible, is to be the touchstone of policy, the government will always come out with bad policy. And that's not something an auditor can help you fix.

MissingMOTHERS

A large chunk of intended beneficiaries are falling through the scheme for pregnant women and new mothers

AN ANALYSIS OF government data on the Pradhan Mantri Matru Vandana Yojana (PMMVY), which supports lactating mothers and pregnant women via cash transfers of ₹6,000, revealed through RTI, shows that, between April 2018 and July 2019, around 61% of beneficiaries who registered under the scheme—38.3 lakh out of 62.8 lakh enrolments—received the total amount. However, it was found that PMMVY failed to reach around 49% of all women who would have had their first delivery—researchers estimated a total of 123 lakh for 2017. The scheme, then, ended up benefiting only 31% of the originally intended beneficiaries. This data highlights the dire straits maternal care in the country is in.

PMMVY is provided to the beneficiary in three installments on the basis of meeting fixed criteria—at least one ante-natal check-up, early registration of pregnancy, and child birth registration. The scheme is highly beneficial for women who miss out on wages due to pregnancy, especially for daily wage workers. As the data shows, the scheme has not been able to do justice in its implementation phase, and the reasons for it can be understood by a recent survey carried out by economists Jean Dreze, Anmol Somanchi, and Ritika Khera. The reasons include lack of awareness amongst women who are rightful beneficiaries of the scheme. Another factor is the fact that the application form in itself is a tedious 23-page long one, and a lot of documents are needed. Also, there are issues of the spelling of names on the Aadhaar not matching that on the bank passbook. Nor does the scheme take into account single women and unmarried women—one of the documents needed is a husband's Aadhaar card. Therefore, the scheme leaves out unmarried mothers. The government must address this issue at the earliest, and make the registration process more women-centric.

FROM PLATE TO PLOUGH

THANKS TO INTEREST SUBVENTION POLICY, LONG-TERM CREDIT IN AGRICULTURE FELL FROM 56.1% IN 1981-82 TO 25.3% IN 2015-16, REFLECTING POOR INVESTMENT IN IMPROVING PRODUCTIVITY

Unravelling agricultural credit

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Views are personal

NORMALLY, CREDIT OFF-TAKE in a particular sector is treated as a sign of performance of that sector. Higher the off-take, better performance is likely to be. From that angle, ground level credit (GLC) to agriculture and allied sectors has shown tremendous off-take. For example, in FY19, the banking sector disbursed ₹12.55 trillion as GLC to agriculture, surpassing the government's own target of ₹11 trillion. This should call for celebration, but, unfortunately, growth in agriculture sector hasn't been commensurate. How does one reconcile this? Let us try to understand and unravel some less known facts about agri-credit in India.

The accompanying graphic presents the absolute amount of direct institutional credit flow to the agriculture sector. There is no doubt that over a longer period, from 1971-72 to 2017-18, there has been more than a 1,000-time increase in agri-credit, from a meagre ₹7.8 billion to ₹8,235 billion. However, as a percentage of agricultural GDP, which should be the real measure of agri-credit growth, it has not been a smooth rise overall these years. For example, during the pre-reform period (i.e., 1971-72 to 1989-90) direct agri-credit flow as percentage of agri-GDP increased at a modest average annual growth rate (AAGR) of 4.2%. However, during 1990-91 to 1999-2000, AAGR decelerated to 3.2%. But, thereafter, during 2000-01 to 2007-08 it witnessed tremendous growth at 12% only to fall back to just 3.6% during 2008-09 to 2017-18. The massive growth during 2000-01 to 2007-08 appears to be due to innovation in credit instrument in the form of Kisan Credit Card (1998), and policy intervention in the form of Interest Subvention Scheme (2006) that incentivised short-term credit. However, the slowdown after 2008 appears to be due to a loan waiver scheme (2008), which led bankers to be more conservative in lending to farmers for fear of increasing wilful defaults due to expected loan waivers in coming years.

Interestingly, the NABARD All India Financial Inclusion Survey (NAFIS) of 2015-16 reported that only 30.3% of all agriculture households availed credit from institutional sources. It could be that the remaining agri-households (about 70%) either don't need credit, or they are not 'bankable', or both. But, the fact that almost 70% of agri-households did not avail institutional credit shows that there is still a lot of scope for the banking sector to increase its reach, be it for production purposes (crop loans), or investment, or even consumption needs.

Government of India started off the interest-subvention scheme in 2006, whereby crop loans would be given to farmers at 7% interest rate. Later, it added a provision for those paying back their loans in time regularly to get crop loans at a 4% interest rate. This is done in a situation where the interest rates in the informal sector, or even through micro-finance institutions generally ranged from 15-30%. This has created a huge opportunity to take large crop loans at subsidised interest rates from the banking sector, and then divert them for non-agriculture purposes. An idea of this diversion of agri-credit to non-agricultural purposes can be had by looking at agri-credit as a percentage of the value of input requirements in agriculture.

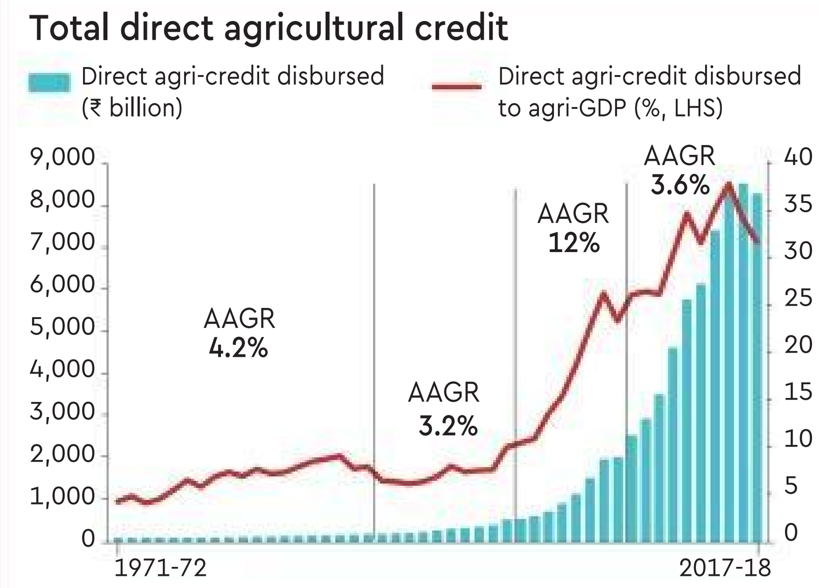
The accompanying graphic presents the state level picture for the triennium average ending (TE) TE 2016-17. The total short-term credit (outstanding) to agriculture and allied sectors as a proportion of input requirements (GVO-GVA) was substantially above 100% for many southern and northern states: Kerala (326%), Andhra Pradesh (254%), Tamil Nadu (245%), Punjab (231%), Telangana (210%) etc (*see graphic*). This is a clear indication that agri-loans are being diverted to other non-farm purposes. One of the key reasons for this diversion lies in low rates of interest being charged under the interest subvention scheme.

Another interesting feature is that in the total direct credit (outstanding) to agriculture and allied sectors, the share of short-term credit witnessed a significant jump from 44% in 1981-82 to 74.3% in 2015-16 whereas, somewhat disquietingly, that of long-term credit fell from 56.1% in 1981-82 to 25.3% in 2015-16. Since long-term credit is basically for investments, and capital formation in agriculture, this dramatic fall in the share of long-term credit takes a heavy toll on the improvements in farm productivity, and overall growth of the agri-sector.

It is, therefore, high time to revisit the interest subvention policy, which is leading to these sub-optimal results. Also, for transparency, all crops loans, especially those availing interest subvention, must compulsorily be routed through Kisan Credit Cards (KCCs). Interestingly, it was reported in the latest economic survey that the cumulative number of KCCs issued was 150 million as of March, 2016, but the NAFIS survey, somewhat puzzlingly, reported that only 10% of farmers have used KCCs in the agricultural year 2015-16. This requires deeper research, but, nevertheless, issuance of KCCs in remote villages needs to be expedited.

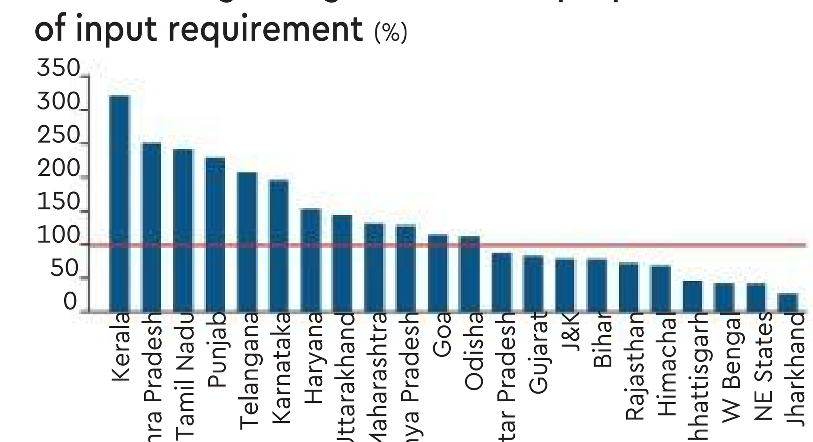
A bolder step in this direction, however, would be to empower farmers by giving direct income support on a per hectare basis rather than by hugely subsidising credit, which is leading to massive diversion of agri-credit to non-agriculture purposes. Streamlining the agri-credit system to facilitate higher crop-loans to farmer producer organisations (FPOs) against commodity stocks can be a win-win model to spur agriculture growth. Can the government plug the diversion, and make agri-credit system more efficient and inclusive?

Total direct agricultural credit



AAGR: Average Annual Growth Rate, Source: Data from Handbook of Statistics on Indian Economy, Reserve Bank of India and National Accounts Statistics, MoSPI

State-wise share of short-term credit (outstanding) to agriculture as a proportion of input requirement (%)



Source: Data from Reserve Bank of India (Report of the Internal Working Group to Review Agricultural Credit, 2019)

Turning the economy around

The key to ensuring that the Indian economy, witnessing its first growth cycle, rises up from its current downward spiral lies in bold monetary policy

MEGHNAD DESAI
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Views are personal

THERE IS NO doubt that we are in the downward phase of a growth cycle. Many critics of the government say that income is declining. It is not; it is growing, but more slowly than before. Cycles normally reverse themselves. The economy hits the bottom, and then starts rising again. Indian economy has not witnessed a cycle before, let alone a growth cycle. Can we be sure that the cycle will reverse itself, and not just continue its downward spiral?

The current growth cycle has been driven by credit, and as I wrote a while ago, is the first capitalist business cycle for India. In such cycles, the downturn is always marked by the insolvency of lenders, bank and non-bank, as well as of borrowers whose projects fail to make profits. When this happens, the way out is not the Keynesian one that increases consumer expenditure. Fiscal policy is not the appropriate instrument; it is monetary policy that is crucial.

Monetary policy in India has been quite timid, and limited. It has price stability as its declared task. Apart from its regulatory duties, RBI seldom takes bold action of the kind the Fed, or the Bank of England has taken in recent years. Given that the malaise is in the banking and non-banking credit markets, it should be the priority of the monetary authorities to fix the availability of credit, as well as to lower the cost of credit.

It is crucial also to reverse the pessimism of the markets. To do this, bold unorthodox policy is needed. RBI should conclude that the recent burst of inflation is a seasonal agricultural phenomenon. It does not require raising interest rates. The policy should be drastic cuts in interest rates, and injecting liquidity on the supply side. If this requires a form of Quantitative Easing suitably tailored to Indian markets, so be it. This is the first time India is experiencing a Wicksell-Hayek cycle, and the response has to be bold.

Thus, the non-banking credit market will have to be supplied with plenty of liquidity at non-punitive rates. The banking sector can be supplied by open market operations of the usual sort. But, it has to be massive. The source of the trouble is the collapse of credit, and this requires sorting out. What the government is good at is compensating farmers, and other distressed groups. But, they are the usual, and frequent, claimants. The need of business investment is paramount, and as profitability has collapsed, the restoration of investment remains key.

> **The Indian economy has matured beyond the days when the government policy had to move the economy directly... the initiative of growing should be with the private sector**

This is a challenging proposition for Indian policymakers. This is because fiscal policy has dominated over monetary policy, as the finance ministry has over RBI. But, now, the Indian economy has matured beyond the days when the government policy had to move the economy directly. Now, the initiative of growing should be with the private sector, and the government can behave as an agent, using the price mechanism rather than direct transfer.

This will not be easy for the government. It does not trust the market mechanism. The government has always treated the public, especially anyone engaged in profit-making activity, with suspicion and mistrust. Forms have to be filled, permits taken, and tax terrorism expected. Time has come to reverse this behaviour into one which helps businesses do what they normally should—invest, employ workers, produce, sell, and make profits while satisfying consumer needs.

The contempt that the political class shows for business (though happy to receive its clandestine donations) is reciprocated by the latter's contempt for official rules and regulations. *Jugaad* is, after all, cheating, cutting corners, and offering bribes to get things done rather than playing straight. The collapse of the non-banking credit market is a perfect example of *jugaad*, and its devastating effects. The NPA crisis in the banking sector is another example.

Debtors have used every means of delaying settlement. The judicial system aids and abets delaying settlement of any and every case. Lawyers are happy to be complicit because the law's delays mean more money for them. Inefficiency is rewarded.

There is a lot of cleaning up to do, not just on our streets, but in our attitudes towards business, be they in offices, factories, or companies. Growth is not automatic, nor can it be conjured up by public spending.

LETTERS TO THE EDITOR

On migratory birds dying in Sambhar

The widespread mortality of migratory birds has not only endangered the species but also enhanced the risk of transmission of fatal diseases/infections to domestic animals and poultry, besides increasing the water and soil contamination levels. Authorities ought to focus on enforcing preventive measures as mere imposition of ban on poaching or penalising the offenders cannot retain visitor-attraction or improve the tourist sentiment. With several thousands of birds, including the migrant plovers, shovellers, teals and mallards having died over the past few days, the unprecedented event calls for an immediate resolution. Real-time monitoring via satellites, drones and internet live-streaming should be established, especially when the migration-patterns are known. Of late, message driven shows with featured appearances and roaring social media platforms, have emphasised the need to improve the level of commitment, to overcome vested-interests and prevent cruelty to wildlife. Extreme conditions and changing vegetation has jeopardised the survival of rare species and migratory birds, appear to be bearing the brunt. Inhospitable conditions, paucity of resources and excessive salination in lake's ecosystem has reduced the number of birds flying in. It is unfortunate that, despite an implied high accountability, the authorities have no long-term data or eco-toxicological studies to support the root cause for this and toxins, bacteria and fungus are assumed to be the usual suspects and the much-needed biochemical investigations are complex and time consuming.
— Girish Lalwani, Delhi

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R.N.I. Reg. No. 6188/61 Printed for the proprietors, The Indian Express (P) Ltd by Vaidehi Chintaman Thakar at The Indian Express (P) Ltd Press, Plot No. EL-208, TTC Industrial Area, Mahape, Navi Mumbai-400 710 and published from Express Towers, Nariman Point, Mumbai-400 021. Editorial & Administrative Offices: Express Towers, Nariman Point, Mumbai-400 021. Phone: 22022627/67440000. Fax: 022-22856323.
Chairman of the Board: Viveck Goenka, Managing Editor: Sunil Jain, Resident Editor: Malini Bhupta* (*Responsible for selection of news under PRB Act)

ILLUSTRATION: ROHNIT PHORE

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Groupthink approach to policy

Is monetary policy right in targeting CPI which sends conflicting signals once we get into the core and food inflation debate?

INTERPRETATION AND GROUP THINK are two driving forces of economic policies in India. Data and statements are open to everyone, but the way they are looked at is interesting. For a long time, we maintained, with a touch of hubris, that India was the best performing economy even if growth slowed down and fewer jobs were created. At the same time, there was an aggressive Groupthink on rate-cuts, which became self-fulfilling as all those who influence policy making thought alike. However, things look quite different, and there is again a buzz.

Industrial growth in the negative territory and CPI inflation at 4.6% is disturbing. While it would be an exaggeration to call it stagflation, it is definitely a sign of low growth and rising inflation. This situation was never really envisaged, growth was to pick up on the back of the harvest-cum-festival season, while inflation was to fall due to a good *kharif* harvest. However, both have not quite played out.

IIP growth in September should ideally have increased for durables goods, in particular, as the e-commerce business was brisk, with both the leaders, Amazon and Flipkart, claiming high growth in sales and penetration to Tier 2 and Tier 3 cities. This should have been ideally backed by higher growth in IIP in September. This also has not happened, and is a substitution for physical sales.

While harvest was supposed to be good, the delayed withdrawal of the monsoon and stormy conditions in November has damaged horticulture products and pulses in some parts. This translates into a fall in supplies, leading to a sharp increase in prices, which has upset calculations.

In such a situation, it is almost axiomatic for one to ask for another rate cut, which is now a habit. This is also happening in the US and Euro region, and, hence, is not surprising. In fact, there has been strong Presidential talk in the US, which is absent fortunately in India where it has been left to the MPC to decide on rate action. The argument being made is that, while inflation has increased beyond 4% and will remain in this terrain for the next few months (can cross 5% if vegetable prices go up further), it should not be considered permanent. Hence, focus should be on growth.

There are two things to be discussed. What exactly is the mandate of the MPC? Is it to react to current inflation number or expected inflation or core inflation or food inflation? Interestingly, one of the earlier Governors of RBI, in a press conference, had clearly said that the legislative mandate of the MPC was to target inflation, and that too headline inflation. There could, hence, be no deviation from this goal. Yet, the MPC has now taken a view that growth is more compelling. With inflation being in the 3% range, it has chosen to lower the rate by 135 bps since February.

Source: CMIE

The second, is that there is an anomaly in reasoning when one looks at the way in which Groupthink moves. The rationalisation is that since food inflation has gone up—core inflation has come down—there is strong reason to lower the repo rate. However, around six months ago when the headline number moved up and was driven by core inflation (house rent, education and health), food inflation during this period was extremely low, the same argument was never made, and the MPC had focused on the headline inflation number. Hence, it would be interesting to see if the MPC breaks away from its conventional approach of viewing inflation and moves to the core inflation aspect when deciding on the rate cut.

A rate cut *per se* has not quite helped spur investment. The 135-bps reduction is, thus, more of a policy move. It really hasn't worked through the system. This is not surprising as there is less appetite for funds and the credit-risk factor is high. Ideally, change in policy rate takes time to go through banks, but markets should react with alacrity. In this context, let us take a look at how the 10-years GSec yields have moved over time. See graph for average 10-years GSec yields for the period December 2018 to October 2019. The repo rate has come down by 135 bps, the yield is down by only 77 bps, which means that the market transmission has not been that even.

This raises the question on why does even the market not react to the repo rate changes? Markets tend to take in a lot of information from different pockets when pricing bonds. Hence, the repo rate and the future direction of the same is just one factor. For these securities, there is considerable uncertainty on the government's fiscal deficit and the incremental borrowing programme. The corporate tax rate cut is to lower the revenue by ₹1.45 lakh crore. GST collections are not on track and there is not much momentum on the disinvestment front. Therefore, the yields reflect this sentiment.

There is a big difference in the way in which the Groupthink directs opinion and the MPC considers the same, and the way in which banks and markets react. Banks have been asked to use benchmarks for pricing their SME and retail loans. The transmission still has not been smooth. Also, the credit risk assessment continues to be apprehensive given the economic environment. Therefore, the way in which players react is different from the thought process of the MPC.

At an ideological level, it is pertinent to ask two questions. The first, whether we are right in targeting the CPI which sends conflicting signals once we get into the core and food inflation debate. The discourse on justification of rate action becomes weak as consistency fades when this picture of inflation composition changes.

The second, whether we should have fewer credit policies with the prerogative to intervene at any time when there is volatility. This is important because one of the reasons to shift to six policies was to remove the noise in expectations on policy. One used to be terrified of getting up in the morning to be told before 9 am that the RBI had slashed or raised the repo rate or the CRR due to adverse market conditions. But, today there is more certainty for sure as Groupthink has led to relentless interest rate cuts, linking the same with the objectives of inflation targeting has gotten blurred.

We clearly need to go back to basics. This is an issue also in the US, where the Fed has lowered rates with inflation at a low, unemployment at its lowest and a steady GDP growth. Friedman and Keynes would both have been bewildered.

RAFALE RULING

Right decision

HARDAYAL SINGH

Former additional secretary, CVC, and chief commissioner, Income Tax

The two rulings on Rafale hold important lessons for vigilance officials

DELIVERED WITHIN THE space of a year, two judgments of the Supreme Court (SC) on procurement of 36 fighter jets from Dassault Aviation is a fine exposition of the legal principles on which our fight against corruption must be based. By declining to direct the CBI to launch roving and fishing inquiries merely on the basis of suspicion, these rulings provide an important contemporary template that vigilance functionaries would do well to follow. SC seemed to imply that the material on record should, at the very least, indicate some evidence of criminal misconduct before the CBI conducts a probe.

A year ago, in the first of these two judgments, SC noted that the Indian negotiating team (INT), set up by the government, apparently negotiated a better deal than the earlier one. There was no reason to doubt the decision-making process because, apart from some minor deviations, it followed the prescribed guidelines. The need for the aircraft was not in doubt, as the earlier negotiations with the same vendor had almost collapsed. The government, therefore, decided to enter into an intergovernmental agreement for the purchase of 36 fifth-generation stealth fighter jets, called the Rafale.

Pricing details were shown, but could not, because of secrecy obligations, be brought into the public domain.

Offset obligations were to take effect only in October 2019; and Dassault, the original equipment manufacturer, was free to choose its own Indian partners for meeting these for the purpose of outsourcing some its manufacturing activity in India. Most importantly, the SC held that it could not act as an appellate authority on all these different aspects of the case. Accordingly, it declined to direct the CBI to register an FIR.

In the second ruling, it merely indicated that it found no obvious error in its earlier judgment and unanimously rejected the review application of the petitioners. Specifically, on matters of pricing, the SC reiterated that it was not the function of the court to determine pricing or issue directions on mere suspicions or perception.

> The rulings address a policy lacunae by making it clear that every loss need not be examined from a vigilance point of view, if due processes were followed

This case differs materially from the earlier case relating to purchase of guns from Bofors: in the latter, there was a smoking gun, with the Swedish public radio broadcaster having specifically claimed on the basis of reliable sources that Bofors had paid kickbacks to obtain the contract.

The two rulings hold important lessons for vigilance officials all over the country: in PSUs and banks, risk-taking forms an integral part of business functions. Every loss need not, therefore, be examined from a vigilance point of view, if due processes were followed.

The SC reiterated that a mere difference of opinion cannot be the basis for launching an investigation. It was legally inadmissible, the SC held, to seize upon such differences to question the final view taken by the decision-makers.

Least of all should superior authorities use hindsight to sit in judgment on commercial/operational decisions of their colleagues. Nor should they insist on exemplary levels of conduct as the benchmark for making references to the CBI. For every official cannot be expected to be outstanding. Finally, just like the courts, a disciplinary authority too cannot sit as an appellate authority on the decisions taken by an official at the relevant point of time. If two views were possible and the decision-maker chose one, his disciplinary authority should not sit in judgment over him for vigilance purposes.

Overall, the SC has undoubtedly settled the important controversy in the Rafale case, but the significance of its two judgments goes much beyond the facts of this case. Defence acquisitions have been mired in controversies for decades. The same is true of credit facilities extended by PSBs, as well as large contracts awarded and purchases made by government departments and PSUs.

Hopefully, such rulings will go some distance in restoring sanity to management of vigilance functions across the country.

The decoy effect

Apple's using decoy effect as a pricing strategy to push its high-priced offerings

VIDYA HATTANGADI

Management thinker and blogger

APPLE'S MOST RECENT launch has led experts to believe that the company's real strategy is pricing. Marketers want to mess up with our capacity to decide if we are indeed getting a good deal, the tactic that Apple favors is decoy pricing. While there are several ways to employ decoy pricing, every instance includes the existence of one product whose sole purpose is to promote the sale of another product. The iPhone 8 and 8 Plus, priced at $799, look shockingly similar to the iPhone7. A closer look, though, reveals that they offer an improved battery life and an updated camera. The iPhone X, on the other hand, stands out as the first phone with a four-digit price tag. The regular version is retailing at $999, with enhanced versions available for a whopping $1,129.99. The pricey phone offers facial recognition, wireless charging and a full screen. There's just one glaring question: are people really going to shell out more than a thousand bucks for a phone? Experts believe that, in order to make that happen, Apple first introduced the iPhone 8 as a price decoy.

In marketing, the decoy effect is one of the phenomenon whereby consumers tend to have a specific change in preference between two options when also presented with a third option that is asymmetrically (lacking symmetry) dominated. The option of asymmetrically dominated, which is often inferior in all respects to one option, but, in comparison to the other options, it is inferior in some respects and superior in others, gets consumed by the consumers. In other words, in terms of specific attributes determining preferences, it is completely dominated by one option and only partially dominated by the other. When the asymmetrically dominated option is present, a higher percentage of consumers prefer the dominating option than when the asymmetrically dominated option is absent. The asymmetrically dominated option is, therefore, a decoy (bait) serving to increase preference for the dominating option. The decoy effect is also an example of the buyer decision theory. To put it more simply, when deciding between two options, an unattractive third option can change the perceived preference between the other two.

Products such as Pepsi or Coca-Cola play this trick. They simply add a third size which resembles the larger one, but is obviously a worse option. The above picture explains how smaller-sized bottle and medium-sized bottle act as decoy 1 & 2 to choose the bigger sized costing $2.18 bottle. In many experiments, the trick has already been proven to work. The decoy effect has even been used to steer people towards creating more secure passwords, we are nudged to create asymmetrical passwords.

The decoy effect phenomenon is a concept of economics, and who knows it better than the widely read magazine, The Economist. The publication cleverly strategises the pricing of their print and digital subscription making the combo look the best deal amongst all. Here is how they price their subscription:

- Web Subscription—$59
- Print Subscription—$125
- Web and Print Subscription—$125

The first offer of $59 seemed reasonable. The second option (only print) seemed a bit expensive, but still ok. But, the third option of both Web and Print for the same price as the print-only subscription attracts most readers in world.

The decoy effect was first investigated as a potential marketing strategy to influence consumer choices. One of the latest research shows that it could also have potent effects in recruitment, healthcare, entertainment, even politics. It shows us just how easily our judgment sways by the context in which the facts are presented; this even when that additional information may have no bearing on the overall judgment. The decoy effect was first documented in the 1980s.

Price is the most delicate element of the marketing mix, and much thought goes into setting prices to nudge us towards spending more. The price of product should be set in such a way that buyers can pay and company can earn adequate profits. In case of price-sensitive customers on one hand and the prestige-sensitive customers on the other hand, the pricing decisions become most vital in marketing.

Customers' price sensitivity can be solved with psychological pricing. Certain prices or the way prices are displayed can influence a customer's decision-making process during a purchase. Such pricing strategies are a simple and cost-effective way to increase sales without reducing product prices. Some pricing strategies tend to play in the emotional side of our brain rather than our rational brain. No price is ever really high-cost or low-cost without having something to compare the cost to; it's all about perceived customer value. Why does our brain work like that? A creative mind can find a lot of possible explanations, all of which may be a little true. But the decoy effect seems to depend at least a little bit on the need to justify a decision to others. Finding the right pricing strategy to sell your products can be challenging and complex process.

How decoys work? When consumers are faced with many alternatives, they often experience choice overload. Psychologist Barry Schwartz has termed the tyranny or paradox of choice. Multiple behavioral experiments have consistently demonstrated that greater choice complexity increases anxiety and hinders decision-making. In an attempt to reduce this anxiety, consumers tend to simplify the process by selecting only a couple of criteria such as say price and quantity to determine the best value for money.