Building ethical assets

Managers must learn to teach business ethics and values

THE WISE LEADER

R GOPALAKRISHNAN

After reading the words above, the reader might wonder what I have been sniffing. After IL&FS, Yes Bank, ICICI Bank, CG Power, business ethics and values? But please, please read on.

There is no denying the monumental ethical blunders by companies, but it only confirms that more effort is required, perhaps from a different source: the line boss. You must influence managers during their "professional childhood when their ethical brain is plastic".

Competitive advantage, which was based on physical assets throughout the industrial revolution, shifted to intellectual assets during the information revolution. In my view, future competitive advantage will shift to ethical assets amidst the AI revolution, which is far more demanding of data transparency. I think that the future could likely belong to strongly ethical companies. Mentoring bosses, management teaching and company trainers must engage with this proposition.

I sometimes think about how my grandchildren will remember me when they have grown up—probably like I remember my grandparents, which is not much! Brain researchers inform us that human memory up to the age of three is virtually nil. From age three to eight, children remember the emotion, but not the facts, of their experiences. Regrettably, all those joyful hours that I spend with my grandchildren in the park, teaching them chess, playing cricket, and taking them to school will not be remembered by them at all; just like I don't recall my grandparents doing so.

However, my grandchildren will remember affection, hugs, kisses and stories that made their eyes wide. Until the age of eight, through emotions and stories, kids learn values and what is right and wrong. The plastic brain of children registers and recalls emotions from very early life but recalls facts and knowledge only from the age of eight. The four principles that every grandparent intuitively deploys are (i) encourage kids by spending emotional time; (ii) impart learning osmotically through story telling; (iii) correct behavioural aberrations early and (iv) immerse into multiple interactive experiences.

During my career, I have learnt that similar principles influence young business professionals about ethics. Ethics is not just about morality, but about sharing, caring and respect. They must be influenced during B-school years and the early years of the career, what I call 'professional childhood'. The ethical brain is plastic and malleable at that stage. Here are five disproportionately value-enhancing experiences that I know.

■ SPJIMR's Abhyudaya: Every MBA student compulsorily mentors disadvantaged children as a part of the MBA course. As students they perhaps do not appreciate it, but later, they treasure the experience.

■ Rural development projects: Hindustan Unilever (HUL) pioneered the idea that every trainee should spend eight weeks, living with a family in a village. Every trainee goes through the experience and leaders honed at HUL are all alumni of HUL's mandatory rural development stint.

■ TAS social service projects: During my Tata career, I was deeply involved in introducing eight weeks of social service for every TAS trainee. They probably did not enjoy the experience, but later, each one would recall how enriching it was.

■ Sustainability in TBEM: It is not just about honesty and integrity, it is also about respect for fellow beings and the environment. Sustainability was introduced into the Tata Business Excellence Model assessment process in mid-2000s.

■ Tone at the top: Children are sensitive observers of elders' behaviour with respect to truth-telling and injustice. Likewise, young managers judge their seniors' behavior rather than their talk. In Tata, the lesson on ethics was salutary when Tata blew the whistle on itself in the face of the unfortunate Tata Finance episode.

In short, lessons on ethics, defined as broader than just integrity, can be imparted even though it is difficult to teach. It is done by deploying the same principles that work in a family.

I feel that lack of ethics and morality is distributed in the same proportion among business as in media, politics, judiciary, administration, religion and NGOs. Business leaders also increasingly realise that reputation matters to employees and customers, who tend to respond to good ethics with loyalty and engagement. Anyway, who wants his grandchildren to carry the burden that their grandfather was unethical?

"The end result of kindness is that it draws people to you," said the late Anita Roddick.

The writer is an author and corporate advisor. He is distinguished professor of IIT Kharagpur. He was a director at Tata Sons and a vice-chairman at Hindustan Unilever

Email: rgopal@themindworks.me

Rural India can't recover until NBFCs do

An intricate web of links between rural incomes, construction activity and shadow banks are fuelling the economic slowdown

PRANJUL BHANDARI

India's economy has hit the brakes hard with growth falling to 5 per cent, from 8 per cent a year ago, and impacting everything from consumption to construction. But how did this slowdown occur so quickly and become so pervasive? We believe much of the blame lies in the strong links between sectors that at first glance can appear largely unrelated.

Our analysis shows that India's ongoing rural distress has been worsened by the slump in the construction sector which in turn has been driven by the serious problems in the shadow banking system that's made up of non-bank financial companies (NBFCs). These three areas make up a large part of India's economy with our analysis showing how the troubled NBFC sector continues to cause widespread pain.

India's rural economy has been in focus since early 2018 when wages in the villages started to fall, unemployment rose, and this toxic combination pulled down consumer spending. Two commonly used indicators of rural consumption — two-wheeler vehicle sales and the production of consumer non-durable goods — have slowed markedly.

Most analysis points to falling food prices as the root cause as it leaves farmers less well off. But this is not the only reason for falling incomes. Rural Indians have increasingly moved away from working in agriculture and moved into construction employment, especially urban construction jobs, and it's this shift that's also amplifying the rural distress.

Our deep dive into the employment status for rural males shows that the reliance on agriculture-based employment has fallen from a 71.4 per cent share of total rural employment in FY00 to 55 per cent in FY18. Over the same period, the reliance on construction-based jobs has risen quickly from 4.5 per cent to 14.5 per cent.

Rural workers were initially attracted to urban construction projects because of the higher wages on offer. But when the building craze in the cities screeched to a halt, laborers rushed back to the villages, putting further downward pressure on rural wages. But why did the building craze halt?

Construction activity suffered because it is dominated by the now-ailing real estate sector. Broadly speaking, 70 per cent of the construction activity is led by residential and commercial real estate. The remaining 30 per cent is driven by infrastructure.

And the real estate sector, in turn, has been badly bruised because it has become too reliant on funding from NBFCs, including housing finance companies. From the perspective of real estate developers, the dependence on NBFC funding has risen sharply over the last few years. In FY18, 100 per cent of the incremental credit taken by real estate developers came from NBFCs, compared to 50 per cent five years ago.

So when that source of lending dried up when the NBFC industry was rocked late last year by a large default, the real estate sector was hit hard. That then had a knock-on effect on the construction industry and subsequently to rural employment and incomes.

So can India's mainstream banks come to the rescue? In theory, yes. But not as easily in practice. Banks work under strict regulatory limits, which do not allow them to increase lending to the real estate sector rapidly. In the quarter ending June 2019, the overall lending to real estate developers contracted as a rise in bank loans was not enough the offset the contraction in NBFC credit.

And if the NBFCs remain cash strapped, funding to real estate developers will remain uncertain and prevent any significant rebound in the construction sector. By understanding all these links, it's no surprise to find that the slump in rural wages accelerated after the NBFC fallout and the real estate slowdown at the end of 2018.

All said, until NBFC lending restarts, construction may not fully pick up, and rural wages may not rise back up quickly either.

This leads us to ask what can authorities do to prevent the slowdown from spreading further? The government has taken an important step by announcing a stimulus package to revive stalled housing projects. This may help solve some of the liquidity issues faced in the real estate sector (where the project is intrinsically sound, but is facing a funding shortfall).

But a second step may also be needed. Given the deep interlinks with the rest of the economy, some NBFCs and real estate developers may need a direct and rescue operation. For instance, the government or the Reserve Bank of India could identify the more systemically important firms, supervise them more closely, find buyers or get owners to recapitalize them, while also making sure the private shareholders shoulder losses. This will help tide over the "solvency" problem (where the net worth of the project is in question).

Either way, we believe India's best bet to arrest the ongoing slowdown is to study the often ignored interlinks across sectors, identify the weakest link, and intervene with full might.

The author is chief India economist, HSBC Securities and Capital Markets (India)

CHINESE WHISPERS

Keeping a close watch

The Bharatiya Janata Party (BJP) is keeping a close eye on its MLAs in Madhya Pradesh. Chief Minister Kamal Nath told party workers recently that the Congress would increase its strength in the Assembly by adding at least two more MLAs. The BJP has taken his words seriously and has asked its organisational office-bearers to be in touch with its MLAs, especially with those who have criminal cases against them. The party has asked them to send updates on such cases. At least 30 BJP MLAs have more than 60 criminal cases registered against them. The party is afraid that the Congress would use these cases as a lever to pressure these legislators. The party lost the Jhabua by-election recently and another MLA, Prahlad Lodhi, was disqualified following his conviction in a criminal case.

Moving on...

Over the past few days, debates on Twitter — both about the microblogging site's allegedly arbitrary rules in verifying accounts as also blocking some Twitter handles for allegedly posting content that flouts its norms — have seen several users moving to Mastodon. On Thursday, the Congress debuted on Mastodon as *@incindia@mastodon.social*. The handle had a photograph of party President Sonia Gandhi with the slogan "Sach Bharat" (true India). Mastodon claims to be a free and open-source self-hosted social networking service. While similar to Twitter and Weibo in most of its features, Mastodon is different since it is not centrally hosted, which allows each operating server its own code of conduct, terms of service, and moderation policies. Users can choose a server with policies they agree with or leave a server that has policies they disagree with without losing access to Mastodon's social network.

Beware fake profiles

The Army has cautioned its officials about 150 fake social media profiles that are being used by "adversaries" to honey-trap and extract sensitive information, sources said on Thursday. They said that an advisory was sent to the Army personnel last month to make them aware of the "trap". An official said people using fake social media profiles had been trying to engage with soldiers by pretending to be fellow Army officers and police persons, or even posing as women. "The profiles are generally two-three years old. So, they do not raise suspicion and appear authentic. It is then that they started targeting," the official added. On Wednesday, Rajasthan Police's intelligence unit arrested an Army jawan who was honey-trapped by an agent of Pakistan's ISI for allegedly sharing confidential and strategic information. He was targeted through Facebook and WhatsApp, they added.

INSIGHT

Rescuing the financial sector

In the concluding part of the series, the author argues that a government with the courage to abrogate Article 370 must not shy away from the banking reform required

JANMEJAYA SINHA

As I highlighted in my last piece, by 2007, the financials of the Indian banking system were robust again. The industry had a return on assets (RoA) of over 1 per cent, gross and net NPAs below 2 and 1 per cent, and a cost income ratio below 45 per cent. Good health prompted the government to re-enact the familiar cycle of pillage. This time to build infrastructure. The new instrument was public private partnerships (PPPs) where the private sector was to build 40 per cent of the $ 500 billion infrastructure target of the Eleventh Plan using PSB balance sheets. During the plan period, 4,910 capital projects of over ₹150 crore were started but unfortunately 2,238 of them were stalled for over two years due to disputes in PPP contract terms or denial of government clearances on environment or land. Two-year delays obviously fully eroded the private equity in the capital projects. The debt-equity ratios of infrastructure companies rose from 1.3 in 2008 to 3 in 2013. Fifty per cent of bank restructured assets were in infrastructure, steel, power and telecom sectors. By 2013 the banking system was back in turmoil.

2013-18 failed clean-up phase: The third phase of Indian banking began with a new governor. In view of the build of bad loans the Reserve Bank of India took a series of aggressive supervisory actions to clean up bank balance sheets to resounding media applause. These aggressive actions neither understood the genesis of the current crisis or the role PSBs had played in funding the government and in effect in keeping Indian democracy afloat as described in my last article. Further supervisory actions were taken, with Brahmanic disdain, to punish the crooked Indian capitalist. Supervisory actions were not supported by monetary policy and inflation had become the singular target of RBI policy.

Seven RBI actions accentuated the banking rot:

■ RBI created a monetary policy committee and set an arbitrary 4 per cent inflation target for India to be managed within a 2 per cent band. Deviations outside the band were to be reported to Indian Parliament.

■ The RBI consistently overestimated inflation and maintained interest rates at the highest levels in the world. It missed the opportunity of using treasury profits for clean-up.

■ An asset quality review (AQR) with tighter recognition norms was started in 2015 to clean up the supposed rot in PSBs, triggering major bank quarterly losses.

■ The easy NBFC licensing regime was continued, but only two new bank licences were issued to IDFC and Bandhan Bank, out of many strong bank license applicants.

■ New type of bank licenses — payments and small finance banks — were introduced without testing the viability of the new models.

■ Regulatory guidelines: Ambiguity in capital norms, holding company structures, and bank ownership norms remained. The old "Washington Consensus" dogmas around diversified shareholdings in banks (despite the lessons of global financial crisis) and a prohibition of industrial houses from owning banks continued, leading to a situation where all new private banks in India today have majority foreign ownership.

■ The welcome Insolvency and Bankruptcy Code was introduced in this period strengthening creditor rights in India.

By keeping interest rates high with the accompanying strong rupee, the RBI induced a slowdown in capital investments and hurt exports; it also prevented banks to use treasury profits to recapitalise. The fast clean up attempted led to a sharp contraction in credit, tightened liquidity for MSMEs and pushed many into bankruptcy. Marginal accounts turned bad leading to capital scarcity and virtually brought bank lending to a standstill. Lending shifted to wholesale funds-dependent NBFCs, increasing risk in the system. Arbitrary low inflation targets, 3 per cent below a 50-year 7 per cent trend line, benefitted only short-term global capital making India the haven for the "carry trade". RBI monetary actions that precipitated the banking crisis were accompanied by rank bad supervision missing the failures — for example, of ILFS, DHFL and now PMC Bank. History will judge the RBI very poorly during this period.

Six urgent actions are needed to rescue the financial sector today:

■ I am not an advocate of simplistic privatisation in India. I believe the State Bank of India should stay government majority-owned and other PSBs should have government as their single largest owner but with a stake below 50 closer to 26 per cent. This is a powerful, overdue, recommendation. It provides these banks the decision-making autonomy required to survive. It removes needless interference and the paralysing fear of vigilance and provides HR freedom to recruit, retain and develop talent. This one act will likely double the price to book of PSBs.

■ Large NBFCs should be forcibly converted or acquired by banks to mitigate systemic risk. Payment and SFBs should be given full bank licenses and stopped henceforth. However, an easy NBFC licensing regime should continue to spur financial innovation.

■ The dual control of cooperative banks and unnecessary tax benefits available to them should be abolished. Similarly old private sector banks should be asked to transform or be acquired by large NBFCs or larger banks.

■ A clean-up of the regulatory structure in terms of guidelines — holding company structures, promoter holding limits, ownership of banks by industrial houses subject to inter group lending guidelines, supervisory oversight of NBFCs — is overdue.

■ The Bank Bureau Board is not needed and there is a need to improve the quality of talent in both the DFS and RBI.

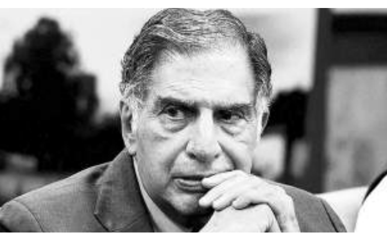
■ Parliament should be apprised on the state of banking — covering, for example, the inexcusable unfilled positions of MD in BoB and BoI.

The new RBI governor should support these actions. There is no excuse for India's banking sector to be moribund. We have the best technology stack and financial services talent globally. Our journey to a $5 trillion economy requires budding entrepreneurs to access credit by banks using technology and data. A government with the courage to abrogate Article 370 must not shy away from the banking reform required. India just cannot wait. (*Series concluded*)

The author is chairman, BCG India

Views are personal

LETTERS



Succeeding success

Apropos the lucid article "Passing the baton... smoothly" by S Suramanian and Nupur Pawan Bang (November 7) about the challenges faced by CEOs and chairmen who succeed legendary business leaders. May I add a few points? When the retiring long-serving top boss is succeeded by someone from within the organisation, the latter generally follows his/her strategy and the organisation may fail to explore new opportunities. If his colleagues do not see him as the right choice, he may have to face more difficulties.

If the person tries to make strategic change, the resistance from his top team may dissuade him and he may have to follow the beaten track because every successor cannot be like Ratan Tata or Anu Aga (mentioned in the article) who overcame resistance and took their companies to greater heights.

Even if he succeeds in the new role, the aura of the parted leader (like Steve Jobs and Bill Gates) keeps haunting the workforce, comparisons become more subjective and the successor may feel under-recognised even if well paid. Finally, it would be indicative of lack of succession planning if the reins are given to an outsider when the organisation is doing well. It may be a risky choice unless the chosen person has an equally high reputation in the industry, quickly understands the organisational culture, gains the trust of the team and delivers results in a short time.

Y G Chouksey Pune

Hand in hand

Apropos your editorial "The Tamil Nadu way" (November 7); a fast developing economy like India needs to integrate all its economic resources, which calls for efficient management of the same. However, India lacks effective utilisation of its manpower resources. The population of the country can be converted into an asset rather than being a liability. It should not be treated as a burden but as an economic tool. Focussing on local markets is thus the ideal solution. Trying to reach out to distant markets leads to higher cost of infrastructure. Industry and agriculture must work in tandem to prevent crippling of other segments of the economy. Large industries should not encroach into agricultural land as it will undermine its capability to source raw material locally, leading to increase in costs and eventually retrenchment of labour.

C Gopinath Nair Kochi

Letters can be mailed, faxed or e-mailed to: The Editor, Business Standard, Nehru House, 4 Bahadur Shah Zafar Marg, New Delhi 110 002, Fax: (011) 23720201 · E-mail: letters@bsmail.in

All letters must have a postal address and telephone number

HAMBONE

Business Standard
Volume XXIV Number 61
MUMBAI | FRIDAY, 8 NOVEMBER 2019

Reviving housing

Investment will depend on how the AIF works

Taking forward Union Finance Minister Nirmala Sitharaman's proposal, announced in September, to provide last-mile funding for stressed housing projects, the Union Cabinet on Wednesday approved setting up a ₹25,000-crore alternative investment fund (AIF). According to the plan, the government will put ₹10,000 crore in the fund, while State Bank of India (SBI) and Life Insurance Corporation (LIC) together will bring in another ₹15,000 crore. The fund will be managed by SBICAP Ventures Ltd. As demanded by various stakeholders, the government has also included projects that have been declared non-performing assets and the ones going through the insolvency process at the National Company Law Tribunal (NCLT). According to official estimates, the fund will target 458,000 unfinished units in 1,600 stalled projects in different cities.

The government has done well to set up an AIF to support the sector instead of directly taking responsibility for completing these stressed projects. The new investment vehicle will have far greater regulatory flexibility than either SBI or LIC on their own would have had. On the face of it, the decision is expected to help in multiple ways. First, this will provide relief to homebuyers whose savings are stuck in these stalled projects, and many are forced to pay both the equated monthly instalments on their home loans and rent. Second, this would help start activity in the real estate sector, which is struggling because of the liquidity crunch and non-availability of funds. Since real estate is linked to several other sectors, it will help push up economic activity in general and benefit specific industries such as cement and steel, which have seen a sharp contraction in demand in recent months.

All this looks good on paper, but things are unlikely to be that straightforward. For instance, some analysts have noted that the fund may not be sufficient to make a meaningful difference on the ground. According to Jefferies, this may be able to fund only 16 per cent of the stalled projects, assuming a 50 per cent rate of completion. Others give a higher figure. The impact, to a large extent, will depend on how SBICAP deploys the fund. It is also not clear as to what kind of returns this fund would be expecting. Besides, the fund may face a fair bit of complexity in the case of real estate companies or projects that are undergoing the insolvency process, or are taken to the NCLT at a later stage. It will not help the cause if the fund gets trapped in legal hurdles and is not able to recover its investment. It is important to note that investment in such funds will depend on the experience of this initiative. If this fund is not able to show good returns, it will be another setback for the real estate sector.

At a broader level, the sector is facing multiple issues. Apart from a liquidity crunch, softer demand because of slower economic growth has resulted in a massive build-up of inventory. This has also led to a significant price correction in various markets. According to one estimate, about 1.25 million housing units are lying unsold across the country. Therefore, at the macro level, the recovery in the real estate sector will depend on a broader recovery in the economy.

Flawed strategy

Regional FTAs are out, but bilateral ones are as tough

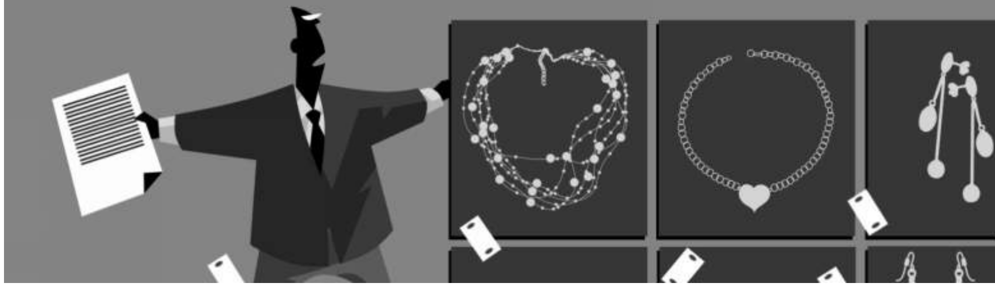
The government's decision to stay out of the Regional Comprehensive Economic Partnership (RCEP), which includes 15 other countries, including the manufacturing hubs of East Asia as well as Australia and New Zealand, is being justified as being part of a strategy of remaining open to trade while ensuring that Indian manufacturers are not exposed to unfair co-operation from China. This is, as a broad-brush strategy goes, not hard to defend. There is much that is problematic about Beijing's approach to international trade, and if the RCEP did not build in the appropriate controls for Chinese exports, then it might well have cost India too much. However, what are the implications if this is indeed the strategy that the government intends to follow?

While multilateral trade rules through the World Trade Organization (WTO) are, of course, the gold standard and India should do its best to ensure that the WTO is revived — especially its dispute-settlement wing — New Delhi's rejection of multilateral and regional agreements like the RCEP means that it is otherwise reduced to bilateral trade agreements with various countries if it wishes to ensure that its exporters have market access. But it should be clear from the RCEP negotiations and the political fallout of those efforts that such bilateral agreements will not be easy to sign.

Consider just the countries that were also part of the RCEP but with which, unlike the Association of Southeast Asian Nations, India does not currently have a trade agreement. Countries like Australia and New Zealand are big exporters of dairy products, for which India is an untapped market as far as they are concerned. Naturally, they will expect market access for their dairy sector as part of any trade agreement. But protecting dairy producers and cooperatives is one of the stated reasons for not signing the RCEP, so how can a bilateral agreement with these nations be signed? Australia, in addition, will want greater access to agriculture more generally, but that appears to be a red line for the Indian government in spite of the benefits for consumers.

Even India's trading relations with the rest of the RCEP countries should be looked at sceptically in this context. It has already put into place some restrictions on the import of palm oil, a commodity in which trade has escalated sharply after the signing of the India-Asean trade agreement. While India's trade deficit with China may be substantial, so is its deficit with the rest of the RCEP countries. Thus, the problem with uncompetitive Indian production is not solved simply by avoiding giving Chinese producers market access. Nor is there much hope from trade negotiations with either the European Union or the United States. The former has been stalled for years, following demands for protection by domestic industry lobbies like auto and — again — dairy. The latter will expect reversals of recent Indian state action on price control in areas such as medical equipment and pharmaceuticals and an end to subsidies and preferences for Indian producers in sectors such as electronics or solar panels. In other words, this new strategy will not amount to much — unless it is only another name for open protectionism.

ILLUSTRATION: BINAY SINHA



Towards a sensible gold policy

The industry should not be overregulated in the name of developing it or curbing black money

WHAT NEXT

Y V REDDY

When it comes to gold, India's policy-making has been less than sensitive to its ethos and the economy. In 1947, restrictions were imposed on import of gold. Then, private ownership of gold bullion was virtually banned: The Gold Control Act, 1962, recalled all gold loans given by banks and stopped forward trading in the metal. In 1963, the production of gold jewellery above 14 carat fineness was banned. In 1968 came another Gold Control Act, which prohibited citizens from owning gold in the form of bars and coins. This legislation killed the official gold market, and a large unofficial market sprung up dealing in cash only. Gold was smuggled in and sold in the black market. Many jewellers and bullion traders were involved in this, creating a thriving underground market. It is a surprise, then, that such an unrealistic policy persisted for so long.

The case for restrictions on gold imports has been that valuable foreign exchange is "wasted". Restrictions on gold trade are meant to divert household savings from unproductive physical form. A tenuous link is often made between black money and gold. This negative policy in the past failed on all accounts and, in fact, created problems over decades. The negative approach was gradually abandoned, commencing with the repeal of the Gold Control Act in 1990, liberalisation of gold imports in 1997, and removal of restrictions on loans against gold, but the inclination to take a positive approach was lacking till recently.

Demand for gold

Most of the demand for gold in India originates from women, and this has to be appreciated in the context of unequal property rights for women and men in the country. Traditionally, gold is inherited by women. Women are deprived of their gold by families only under desperate circumstances. Gold provides safety and security for women, and under difficult circumstances, liquidity for the whole family. Gold is a form of collateral, not only for the common man in distress but even for the Reserve Bank of India (RBI) and the Government of India when there is a crisis, as in 1991.

However, the problem is that the common man seeking to buy or sell gold is not always assured of its quality and often gets cheated. People who buy gold deserve as much consumer protection as buyers of other commodities.

Positive approach

In 2015, three initiatives were taken: One, a gold monetisation scheme allowed depositors of gold to earn interest on their metal accounts and the jewellers to obtain loans against their metal account. Two, a sovereign gold bond, as an alternative to purchasing metal gold, was issued. The bonds carry a fixed rate of interest, and are also redeemable in cash by the holder based on the value of the gold at the time of redemption. Three, Indian gold coins were launched that provided an assurance of quality to buyers and reduced the demand for coins minted abroad, thus enabling recycling of the gold available within the country.

In the monetisation scheme, value of the gold is protected and interest is obtained by the depositor, but she has to convert existing jewellery into gold for deposit purposes and, if necessary, will have to convert the gold back into jewellery on maturity of the deposit. If the scheme is made attractive, people may be tempted to buy gold and deposit it in the banks. In that case, import of gold may increase. The banks do not find the scheme attractive because it means extra holding costs if they do not find borrowers for the gold deposited simultaneously. In many ways, the scheme continues to be impractical, except in the case of holders of large quantities such as temples.

The gold bond is like any other bond issued by the government, except that it is denominated in grams of gold instead of rupees. Such a bond is attractive to those who wish to have the monetary benefit of holding gold without physically holding it. Further, as an asset class, it provides diversification benefit akin to having a foreign currency asset. However, the government will have exposure to gold price risk. The movement in gold prices so far has not been favourable to the government. There is another risk: If the gold bond scheme becomes hugely successful, the government may find its mainstay, namely rupee-denominated instruments, undermined.

Under the coin scheme, gold coins can be purchased and sold at the prevailing market value. It is certainly attractive for individuals holding savings in the form of physical gold with characteristics of liquidity and authenticity.

The government has also been trying to bring more transparency into gold trade. It made it mandatory for customers to disclose their tax code, or Permanent Account Number, for high-value gold purchases. A circular was issued on tax aspects of gold jewellery holding by households. In July 2017, the Goods and Services Tax on gold was raised to 3 per cent from 1.2 per cent.

The way forward

The NITI Aayog Report in 2018 is a positive policy document on gold. The recommendations are wide ranging and include gold mining, gold refining, hallmarking, exports, digital payments, and new institutional arrangements, viz, the Bullion Exchange of India and the Gold Board of India. What should be the way forward?

First, we should not commit the mistake of having unfair, insensitive and unrealistic policies as in the past, but we should not go overboard in supporting the gold economy either. Second, the policy should avoid putting requirements and restrictions on millions of households on gold in the guise of curbing a form of black money kept by a few unscrupulous elements. Third, we should be spending taxpayer's money primarily on consumer protection. Fourth, the experience with various schemes undertaken recently should be reviewed to determine whether the instrument itself is wrong, rather than assume that the instrument or scheme should somehow be made to succeed. Fifth, as gold has the characteristic of a currency globally, the RBI has to play a central role in the gold policy. At the same time, consumer protection and export promotion should be major concerns for the government.

Finally, the broad approach to a positive gold policy should recognise gold's unique character as a reserve asset for central banks and its importance for the domestic economy as well as the external sector. A positive policy approach should certainly recognise the importance of gold in our economy and society, especially for women, but it should not subsidise or overregulate the industry in the guise of developing it or curbing black money.

The writer is a former governor of the Reserve Bank of India

Minimum wage macroeconomics

RATHIN ROY

The government has taken several policy initiatives to address the current economic slowdown. These important and necessary measures to ameliorate the slowdown have addressed (1) sentiment, (2) the credit pipeline, (3) policy misinterpretations, and (4) sector specific issues. However, if, as I have been arguing, the roots of the slowdown lie in deficient structural demand, then other measures are needed.

The structural demand problem has its roots in the historic pattern of growth since 1991, which is powered by the goods consumed by the top 150 million, reflected in the fact that high frequency leading indicators of the economy measure items only these people consume. At the heart of the structural demand problem is the fact that (1) the vector of relative prices is not conducive to broad-basing aggregate home market demand, (2) low productivity limits the scope for a substantial increase in exports and, in the case of mass market textiles, inhibits import substitution, ceding home market demand to Bangladesh and Vietnam. In the first case, relative prices of things that the top 150 million consume — automobiles, air conditioners, etc — have hugely decreased over the past 20 years; thus an air conditioner that would have cost an entry-level civil servant a year's salary in 1989 now costs less than a month's salary. However, the same is not true of things consumed by those earning incomes at, or even triple, the minimum wage, such as nutritious food items, affordable housing, healthcare and education.

When relative prices do not serve the national good, then there is a case for government intervention, especially when distorted relative prices are a driver of macroeconomic slowdown. This case was made by John Maynard Keynes for developed countries and was part of the standard macroeconomic toolbox until 40 years ago. It is back in the toolbox as neo-liberal macroeconomics is in discredited tatters after the 2008 crisis. In essence, the macroeconomic role of wages is expressed through linking the wage share to consumption and, transitively, to aggregate demand. The wage share could rise as unemployment falls and/or wage rates rise. This relationship is mediated through an incomes policy, which acts to secure relative prices of labour and capital that are consonant with macroeconomic stability.

In developing countries, the problem was often expressed in terms of a wage good constraint limiting home market demand, driven, often, by low returns to agriculture employment. But India is now a market-driven economy and, therefore, a contemporary incomes policy mediates relative prices through a national floor minimum wage (NFMW). For this reason, I welcomed the code on wages, 2019, which stipulated a NFMW. This key reform uses the consumption power of the *aam aadmi* to leverage economic growth.

"In principle" objections to this measure come from neo-liberal economists who are out of date. The balance of contemporary theoretical[1] and empirical[2] research establishes that NFMW contributes positively to aggregate economic welfare and growth, and that any negative employment effects are offset by the positive impact on human capital formation and the stability and magnitude of aggregate home market demand.

Micro principles vs macro approach

Arguments for a minimum wage in the Indian context have been based not on macroeconomic reasoning but on some notion of a safety net and Victorian notions of relative status. The calculation of the proposed NFMW is based on the basic needs that a family would need to feed, clothe, and house itself at a basic level with some additional amount for emergencies. Thus, the proposed NFMW allows for a net intake of 2,700 calories per household member, which is not significantly higher than the intake used to define the poverty line. At the same time (as I discovered as a member of the Seventh Central Pay Commission), the Government of India used a 1950s metric called the Aykroyd formula, which provides for a more diverse and better quality basket of consumption in line with the supposedly higher status of a government employee. This tends to be 40-50 per cent higher than the minimum wage stipulated for everyone else.

This approach is attractive to an old-fashioned socialist or feudal who sees minimum wages through a prism of class struggle/class hierarchy but not very helpful if the minimum wage is seen as the cornerstone of a macroeconomic incomes policy. There is no literature on this subject since it is only now with this government that we have a NFMW.

The NFMW should be determined based on macroeconomic considerations, namely (1) whether the NFMW would increase aggregate demand for mass market consumption. (2) Whether there are supply bottlenecks in responding to such aggregate demand and, if so, calibrate the NFMW to not cause inflationary pressures by driving up demand that would not elicit a domestic supply response—mass market textiles is a good example. (3) The impact of the minimum wage on the factor distribution of income— that is, wage and profit shares should be a key consideration not from the point of view of equity, but from that of macroeconomic stability and growth optimisation. (4) Subnational minimum wages could be set above the floor as desired with other considerations in mind.

Bear in mind that this approach has macroeconomic trade-offs. A higher NFMW may mean lower profits and, therefore, lower taxes and lower public expenditures/fiscal stress. The NFMW may be lower than desired by those concerned with household welfare, dignity of labour, etc. Political pressures to raise the NFMW may defeat the macroeconomic purpose in economies with weak political buffers. So these complexities will need to be addressed. But they do not detract from the need for an incomes policy, anchored in a NFMW determined by macroeconomic considerations, which is of urgent importance in the face of the structural demand slowdown. -

The writer is director, National Institute of Public Finance and Policy. Views are personal

1. Cahuc and Michel (1995); See Fanti and Gori (2010); Askenazy (2003)

2. Dube et al. (2007); Belser and Rani (2012); full references in the web version on nipfp.org.in

Defender of a faith

BOOK REVIEW

A K BHATTACHARYA

The greatness as well as the complexity of the Hindu belief system is that there is no one precise way of defining it. For instance, there are Hindus who are believers and there are also Hindus who are non-believers. There has always been room for both varieties of people in the world of Hindus. Not without reason has it been said that Hinduism is not strictly a religion but a composite and syncretic way of life.

In his latest book, *The Hindu Way: An Introduction To Hinduism*, Shashi Tharoor, a prolific writer and a current member of Parliament, makes a brave attempt to bring out the diversity and several apparent contradictions in the many ways Hindus observe their religion and practise their beliefs. Mr Tharoor's lucid English prose is his asset and in this book he eschews the many difficult words for which he has now acquired a reputation. Neither does the book have a "farrago" of Hindu mythological tales, nor does the author indulge in "rodomontades" about his knowledge of Hindu scriptures.

Quite to the contrary, Mr Tharoor could be accused of having made minor compromises by endorsing the mistaken belief that the popular phrase of *Vasudhaiva Kutumbakam* (the world is my family) is derived from the *Rig Veda* or by wrongly suggesting that names such as Vijay, Anand and Ashok (the Amritraj brothers from the world of tennis) have a Hindu religious connotation. There is an obvious need to distinguish between the *Upanishads* and the *Vedas*, just as the distinction between a Hindu name such as Sivaramakrishnan and completely non-religious names such as Shyamal or Kanika should be kept in mind.

Nevertheless, the five sections containing 14 chapters in Mr Tharoor's book is a good introduction to prevailing Hindu beliefs, particularly for someone who is a complete stranger to Hinduism. To most Indians, the detailed account of Swami Vivekananda or Adi Shankara will hardly reveal anything strikingly new. But to the uninitiated foreigner, the book is a good starting point in understanding the Hindus. And those who want to know more, there is a diligently compiled list of books for further reading.

What makes Mr Tharoor's book easy and readable is the highly personalised account of his interface with the various facets of the Hindu religion. His realisation of the importance of caste provides a fascinating account of an India that has not changed very much from what it used to be half a century ago. The young boy in his Bombay (now Mumbai) school who made him realise that he belonged to the Nair caste is not named, but the author's description leaves very few in doubt who he was actually referring to and it underlines the role caste plays in even urban India. Similarly, a short section of the book is devoted to why he loves to worship Ganesha, the elephant-headed Hindu god, and how he came to understand his many facets.

The book also has many short and simplified stories from Hindu scriptures including the *Mahabharata* and the *Ramayana*, which for instance explain weighty issues on caste and ethics. Thus, Mr Tharoor narrates the heart-rending story of Eklavya, the low-caste archer who had to sacrifice his right thumb to satisfy his Brahmin guru's wishes, and explains in another context the logic of killing one's near and dear ones, propounded by Krishna in the *Geeta*.

The chapter on the proliferating business of Hindu gurus touches upon a disturbing phenomenon. The Hindu religion has, in the last many years, manifested itself in a highly distorted manner. The rapid rise of gurus with huge mass followings is an example. Many of these gurus have exploited their religious appeal for commercial gain. Critics will find this section to be slightly biased in the manner in which only a few of these gurus have been highlighted while many others are simply ignored. This was perhaps because of the obvious limitation of space, but the exclusion of many gurus with dubious credentials suggests that the author may have played safe by avoiding any controversy.

It is in the last section of the book that the author reveals the politics that is behind the manner in which the Hindu religion has expanded its footprint and become more popular in different ways including as a tool for political mobilisation. Mr Tharoor rejects the idea of an intolerant Hindu religion, arguing that tolerance and acceptance of diversity are integral to Hinduism. He is unequivocally critical of the obscurantist political parties that have been propounding the idea of a Hindutva thriving on division and exclusion.

That is also a political question that the author leaves readers with. It is noteworthy that Mr Tharoor does not dwell on this issue adequately, in spite of having raised it in the last section of the book. The role of Hindutva politics in India for the next few years is critical for the survival of many political leaders such as Mr Tharoor, who professes to be a different kind of a Hindu and abhors the idea of narrow, caste-obsessed, Hindu majoritarian politics. In that sense, the book seems to be an attempt by Mr Tharoor to reiterate his political convictions and relevance in an India that is rapidly changing its political colours.

THE HINDU WAY: AN INTRODUCTION TO HINDUISM

Shashi Tharoor; Aleph, 340 pages, ₹ 799