Reform by notification

Four labour codes take the reform process forward, but reliance on notifications in a few areas raises questions

RAISINA HILL

A K BHATTACHARYA

India's labour policy has acquired a new look. Four labour codes are now in the public domain and these are the Code on Wages, the Occupational Safety, Health and Working Conditions Code, the Industrial Relations Code and the Code on Social Security.

The Code on Wages was passed by Parliament in early August and the Industrial Relations Code was introduced in the Lok Sabha on November 28. The Occupational Safety, Health and Working Conditions Code was introduced in the Lok Sabha in July, but referred to the Standing Committee of Parliament in October. Its report is expected next month. The draft Code on Social Security was approved by the Union Cabinet on December 4 and is expected to be introduced in Parliament soon.

As many as 28 different labour laws have been subsumed in the four codes — 13 in the Occupational Safety, Health and Working Conditions Code, eight in the Code on Social Security, four in the Code on Wages and three laws in the Industrial Relations Code.

It was a long journey, showing once again how slow is the pace of economic reforms in India. The Second National Commission on Labour had submitted its report in June 2002, when Atal Bihari Vajpayee was the prime minister. It had recommended that the existing labour laws should be amalgamated and grouped under five broad heads — (a) industrial relations, (b) wages, (c) social security, (d) safety; and (e) welfare and working conditions.

For well over 17 years, experts and civil servants discussed the implications of these recommendations under three different governments — two led by Manmohan Singh and one by Narendra Modi. The long years of deliberation also reflected the governments' general reluctance to reform laws that might be politically controversial. It was only in the second term of the Narendra Modi government that a decision was taken to merge the various labour laws under four categories — the Commission's recommendation was slightly tweaked by grouping the laws on safety, welfare and working conditions under one code.

What do the four codes of labour policy tell us about the state of reforms in a key segment of the economy? There are four important takeaways from this massive exercise.

One, the Union government has diluted its own role in an important area of labour policy. The Code on Wages restricts the role of the Centre in framing wage-related policies to only railways, mines and oilfields. In all other sectors, the states would be given the freedom to frame wage policies. This implies that a host of central laws that govern wages for several industries will cease to be effective. Similarly, on minimum wages, the Centre and the states could frame their own wage levels, but these cannot be lower than the floor wages that the new Code would stipulate for different geographies within the country.

Two, the new laws have substantially reduced the powers of the inspectors of the labour department. The Code on Wages, for instance, ensures that the inspector-cum-facilitator shall give an opportunity to the employer before initiation of prosecution proceedings in cases of contravention. The inspector can initiate prosecution proceedings only when there is a repetition of the contravention within a period of five years. In the draft Code on Social Security, the inspectors' power to call for documents on provident fund records has been subjected to a limitation period of five years, beyond which inspectors cannot access such records.

Three, the new labour policy's reliance on notifications has seen an increase that may not make the legislators in Parliament very happy. Of course, the Industrial Relations Code retains the old provisions that required employers of industrial establishments with at least 100 workers to take prior permission of the central or state government before lay-off, retrenchment or closure. But now it also gives the freedom to the central and state governments to modify the threshold number of workers in establishments by notification. Similarly, the draft Code on Social Security permits the government to change the threshold for coverage of an establishment under the Employees' Provident Fund Organisation or the Employees' State Insurance Corporation by issuing a notification.

Four, the new labour policy has hugely expanded the scope of the coverage of the law to include new categories of employees. The Industrial Relations Code covers the fixed-term employees and ensures that they get all the statutory benefits like social security and wages on a par with the regular employees doing similar work. The Occupational Safety, Health and Working Conditions Code stipulates that the new law would apply to more sectors of industry including theatre, films, entertainment and media. The draft Code on Social Security ensures that gratuity and insurance benefits are made available to the fixed-term employees and to all those who operate in the app-based sharing economy or the gig economy and work in companies like like Uber, Ola or Swiggy.

The Indian economy is bound to be impacted by these major labour policy changes. But how these changes pan out will be known in the next few years.

CHINESE WHISPERS

'Encounter' war

Even as the Telangana police won praise on social media over the alleged encounter of the Hyderabad rape and murder accused, a war of words has broken out between the Adityanath government in Uttar Pradesh and the Bahujan Samaj Party (BSP) on Twitter. After the BSP grabbed the opportunity to hit out at the Adityanath government, suggesting the UP police "learn" from its Hyderabad counterparts, the former retorted with statistics on encounters it has under its belt. Its Twitter post said 103 criminals had been killed by the UP police in 5,178 encounters in the last two years or so, while 17,745 criminals had either surrendered or cancelled their bail to go to jail voluntarily. The tweet saying "Hardly state guests" made an oblique reference to the 1995 state guest house incident, in which BSP supremo Mayawati *(pictured)* was allegedly attacked by some workers of its on-off ally Samajwadi Party in Lucknow.

Transfer orders

The Andhra Pradesh government has issued an order restricting the tenure of employees, both contractual as well as outsourced, who work as *peshi* or as the personal staff of ministers and other senior officers, to three years. The move is aimed at curbing corruption and preventing leaks of crucial information. Henceforth, it will be mandatory to transfer the staff after they complete three years in their postings. The tenure was seven years. Will this mitigate instances of wrongdoing? Only time can tell.

Grand celebration

The Congress-led government in MP is set to complete a year. The party and the government are planning to celebrate its "successful one year" on a grand scale. The government, which assumed office on December 17, 2018, will publish a book titled *Logon ki sarkar, Log hi Sarkar* (people's government, people are the government). All ministers have been asked to work on the PR outreach for the book, which is being printed. Sources say the ministers have been specially asked to compare the first year's success with the 15 years of the previous Bharatiya Janata Party government, while promoting the book.

Floccinaucinihilipilification or Panglossian?

The no-rate-cut policy and preference to wait for the Budget and clarity on fiscal front demonstrate Shaktikanta Das is maturing in his new role

BANKER'S TRUST

TAMAL BANDYOPADHYAY

Globally, central banks have stopped surprising the markets. Most prepare the markets for what they do. The latest Reserve Bank of India (RBI) policy is an exception to that trend. Can the non-action be read as status quo or a pause or even postponement of the inevitable? It's a surprise but the shocker is all six members of the monetary policy committee (MPC), including the eternal dove Ravindra Dholakia, endorsing it.

Of course, there is an unambiguous forward guidance: The pause is temporary and there is monetary policy space for future action.

Since the beginning of the rate cutting cycle in February, barring the latest meeting, the MPC has always cut the rate — overall by 135 basis points (bps), from 6.5 per cent to 5.15 per cent. There have been precedents to such cycles. But have we ever seen such a long and deep cycle of cutting GDP growth estimate to accompany it? Since February, each policy, including the latest one, cut the growth estimate — overall by 240 bps, from 7.4 per cent to 5 per cent. One bps is a hundredth of a percentage point.

The slowdown is a concern but inflation seems to be a bigger worry and the MPC is not willing to take any chances. The retail inflation projection has moved sharply upwards to 5.1-4.7 per cent for the second quarter of 2020. Food, fuel and a hike in telecom tariff are contributing to the rapid rise in inflation. Going by this projection, a rate cut is unlikely in February and even in April. It could be a long pause. The next rate cut could happen in June (if by that time growth does not pick up) after the full-year GDP figure is known and the impact of the Union Budget has sunk in.

Has the MPC taken a wrong call? Or, has it preferred to play safe (because of rising inflation)? I think, it's neither. It's a smart move. Using the rising inflation as an excuse, it has lobbed the ball to the government's court. Central banks globally, including a few emerging markets, have started demonstrating the limitation of the monetary policy. The fiscal policy needs to play its role for lifting growth.

Probably the MPC would not mind the government breaching the 3.3 per cent fiscal deficit target for 2020 but it wants clarity on the extent of fiscal slippage. If the fiscal deficit expands — which it will — and the government borrows more from the market, the RBI will have very little choice but buy bonds. However, that's a different story. After the policy announcement, there was a mild sell-off and the 10-year bond yield rose around 15 bps. Unless the RBI acts, it will inch towards 7 per cent, negating the benefits of the series of rate cuts.

How has been Das's first year on the Mint Road? It is definitely not a year of "floccinaucinihilipilification" — the 29-letter word used by MPC member Chetan Ghate that refers to an action or habit of estimating something as worthless. One also cannot say Das maintained a "Panglossian" countenance through the year, smiling away every difficulty.

A bureaucrat who had worked with three finance ministers with elan and had played a key role in planning and executing the demonetisation drive — which many believe is one of the contributing factors to the current slowdown — Das took over as India's chief money man last December after Urjit Patel stepped down, abruptly ending an acrimonious relationship with the finance ministry.

The first thing Das did was reduce the conflict between the government and the RBI which was as intense as the US-China trade war. Behind the conflict were multiple issues — ranging from the government wanting more money from the central bank's reserves to the RBI restricting many unhealthy government-owned banks from giving fresh loans. Das tackled all these with ease and made the long and stormy central bank board meetings into a non-event in no time.

He also opened the gates of communications with all stakeholders — something which was missing in the previous regime. I don't know whether the *glasnost* influences his thinking but by reaching out to the bankers, bond dealers, analysts and economists, he has built in a consultative process which the market is lapping it up. It has its downside too. One offshoot of this consultative process is the time taken to put in place an external benchmark for bank loans which delayed the transmission of rate cuts.

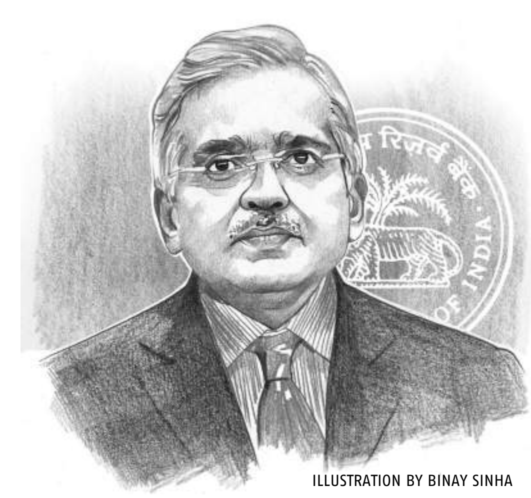

ILLUSTRATION BY BINAY SINHA

Among other important things, he has stripped the National Housing Bank of its regulatory function following its abject failure in managing the housing finance companies. He has also opened the window to give licence to more small finance banks and the struggling payments banks can convert themselves into small finance banks.

He has been instrumental in diversifying the liquidity management toolkit of the RBI by launching dollar swap auctions — buying dollars from banks and releasing equivalent amount of rupees in the system when liquidity was tight. Other interesting decisions include allowing non-resident Indian participation in the rupee interest rate derivatives markets and making electronic fund transfer round the clock.

To be fair to him, he saw the economic slowdown coming and started cutting rates just in time. But he did not anticipate the severity of the slowdown. So, he stuck to the baby steps — cutting rates by 25 bps each time even as paring the growth projections by a wider margin. Only once he pushed for an unconventional 35 bps rate cut, saying 50 bps was not required, but followed it up with another 25 bps cut after two months. And, like the economic slowdown, both the RBI and the government underestimated the shadow bank crisis and allowed the problem to fester and spill over to real economy.

One media report says even after a year, Das's heart is still in the finance ministry. His soul is certainly with the central bank. Some of the finance ministry bureaucrats take time to settle down on Mint Road — he is one of them. The December policy could be the tipping point. The no-rate cut policy and preference to wait for the Budget and clarity on the fiscal front demonstrate Das is maturing in his new role.

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INSIGHT

Get power tariffs right, please

Offering free electricity is regressive; focus on tariff rationalisation and targeted subsidy

VIVEK SHARMA

The recent tariff subsidy bonanza announced in New Delhi for residential consumers of electricity — of up to 200 units/month — might gratify the public, but goes against economic rationale. Instead, tariff rationalisation and targeted subsidy would go a long way in sustaining the reform momentum started by the Ujwal Discom Assurance Yojana (UDAY). UDAY focused on turnaround of distribution companies (discoms) through cost reduction and improvement in operational efficiency. While it has improved some operational and financial aspects, discoms remain utterly fragile.

The UDAY dashboard shows reduction in aggregate technical and commercial (AT&C) loss to about 22 per cent. Cost recovery has improved, too, with the gap between average cost of supply (ACS) and average revenue realised (ARR) narrowing to ₹0.40/unit as on September 2019.

However, going by the scheme's current performance, the Centre is likely to miss the final target of reducing ACS-ARR gap to ₹0/unit, and AT&C losses to 15 per cent by 2020. The gap is significantly high for some states (Rajasthan about ₹1.25/unit, Bihar about ₹0.93/unit, Andhra Pradesh about ₹0.67/unit, Tamil Nadu about ₹0.78/unit, and Uttar Pradesh about ₹1.1/unit.

Indeed, the overall gap translates to approximately ₹62,482 crore of loss annually. This is over and above "regulatory assets" worth around ₹1.35 trillion created on the balance sheets of discoms because of previous gaps.

As things stand, tariffs do not reflect the cost of supply for some consumers. There is little to no improvement in cross-subsidy levels for industrial and commercial consumers. These tariffs are among the highest in the world, which impacts the cost competitiveness of industries.

As per the Report on "Roadmap for Reduction in Cross-Subsidy" by the Forum of Regulators, cross-subsidy for industrial consumers in Gujarat, Tamil Nadu, Rajasthan, Punjab, Maharashtra, Karnataka, Uttarakhand, and Madhya Pradesh was higher than the ceiling of 20 per cent set by the National Tariff Policy (NTP). The NTP 2006 and 2016 prescribe criteria for cross-subsidy, envisaging a gradual reduction. In many cases, industrial and commercial tariffs are 50-100 per cent above the 120 per cent ceiling prescribed.

And that's not all. The cost of supply is still way higher for low-tension, or agricultural and domestic consumers, compared with high-tension, or industrial and commercial consumers. That is because the more the money needed for last-mile connectivity, the greater are the losses incurred. Therefore, cross-subsidy levels based on "actual" cost — and not average cost of supply — is very high and unsustainable.

Delhi has one of the highest per capita incomes and highest electricity consumption. It also has perhaps the best quality of electricity supply. Do consumers there even need the subsidy?

Delhi also has a cushion of fiscal surplus, which makes such unnecessary doles "affordable" — something states with low per capita, poor quality of supply, and constrained fiscal health can ill-afford. Indeed, as the table (*How they stack up*) shows, Uttar Pradesh and Bihar — with poor capita income and erratic supply — are among the worst off.

HOW THEY STACK UP

	Monthly per capita Income (at current prices)* (₹)	Per capita residential electricity consumption# (Kwh)
AP	13,669	185 units
Delhi	30,461	1,000 units
Bihar	5,113	30 units
UP	3,652	42 units

*Per capita income is the estimate from respective state economic handbooks, published by state planning departments. #Per capita electricity consumption is (energy generated + net imports)/total population
Source: Economic Survey of Andhra Pradesh, Delhi, Bihar and Uttar Pradesh (2018-19), Central Electricity Authority and Ministry of Power

The total subsidy and cross-subsidies of discoms at about ₹1.2 trillion in 2018. Such high levels, coupled with ACS-ARR gap and regulatory assets, would render the power sector powerless, impacting fresh investments in generation and transmission, as well.

Not all is lost, though. Three proactive measures can address the situation:

■ Calibrated tariff hikes: Just like diesel prices were deregulated with a monthly increase of ₹0.50/litre, electricity tariffs could also be tweaked up monthly/quarterly for at least three years, based on predetermined percent that may include some realistic efficiency inbuilt. Some may argue that this amounts to passing on potential inefficiencies of the distribution entity to the consumer. But the fact is, there is a large ACS-ARR gap, accumulated losses, and piled up regulatory assets that need to be cleared. This would be subject to regulatory scrutiny at the end of the three-year period.

■ Guidelines for cross-subsidy reduction: To reduce the cross-subsidy on industrial and commercial customers going forward, state regulators need to implement reduction in cross-subsidies and removal of political inertia in increasing domestic and agricultural tariffs gradually. Ultimately, subsidy (if required), directly must go only to deserving consumers, with low per capita income or below poverty line.

■ Direct benefit transfer (DBT): To plug leakage and ensure targeted subsidy, DBT could be implemented. States may replicate in the power sector what the Centre successfully did with liquefied petroleum gas subsidies.

Sans tariff rationalisation and targeted subsidy, all other reforms efforts — including open access, retail-supply separation, and even public-private partnership/privatisation — will not yield the desired results.

The author is senior director, CRISIL Infrastructure Advisory

LETTERS

Tighten the noose

This refers to the editorial "Protect ordinary investors" (December 5). Notwithstanding the rise in loan-related frauds, many lenders are in the habit of disregarding the guidelines of the RBI, thus benefiting the unruly borrowers causing losses to the banks and eventually, adversely affecting the financial system. It is imperative to conduct a thorough probe into the granting of loan against third party shares belonging to the retail investors. In this case, the brokers pledging the shares must have an irrevocable authority to pledge the shares. If it is in the negative, it denotes that the broker firm that created the pledge has transferred a defective title to the lender and hence, the lender must recall the credit facility.

The market regulator must bolster its oversight on the activities of the share brokers to ensure that the retail investors' interest is protected; else they too will flee from the market thereby negatively impacting market stability. Loans against shares are riskier vis-a-vis other types of loans. Though the RBI has stipulated tight norms for lending against shares, the lending in this category is not fair, and therefore it must tighten its oversight to secure the loans and advances against shares.

VSK Pillai Kottayam

Logical stand

This refers to the editorial "Inflation warrior" (December 6). You have rightly appreciated the action of the Reserve Bank of India's (RBI's) monetary policy committee (MPC). The apex bank, often the target of criticism for kowtowing to the wishes of the government, has done the right thing by not reducing the policy repo rate. The decision shows maturity of thinking, detailed study and logical interpretation of the ground realities and application of mind for arriving at a unanimous decision.

The markets were indeed surprised because everyone was hoping that rate cuts will continue and the cumulative 135 basis points since February will become 160 or more. But the central bank's role is not only to keep the markets happy. It has a much bigger, overarching role to keep a sharp eye not only on inflation but also on the economic growth in a holistic manner. One must applaud its stand.

Let it continue with the declared stand and also work towards "an appropriate balance between the fiscal and monetary policies". It is prudent on its part to wait for the Union Budget, give more time to banks to reflect on the effect of earlier cuts in lending rates and perhaps also get a better idea about food inflation.

Krishan Kalra Gurugram

Being cautious

This refers to the editorial "Inflation warrior" (December 6). Controlling inflation has always been the main concern of the RBI. On many occasions, the RBI did not cut repo rate much to the disappointment of the government that wanted the cut to spur growth. This is precisely because the RBI gave preference to inflation control over growth push. However, in the last few occasions, RBI went for a repo rate cut to address growth concerns.

This time around, with its decision, the RBI wants to assess the impact of stimulus measures announced by the government to revive growth and decide accordingly once the picture is clearer. The editorial rightly sums up that the current pause shows that the MPC will use the available policy space more judiciously. Clearly, the RBI does not want to commit anything as yet.

Sanjeev Kumar Singh Jabalpur

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Business Standard
Volume XXIV Number 82
MUMBAI | MONDAY, 9 DECEMBER 2019

Fixing the GST

Fundamental improvements to the flawed structure needed

It has been reported that the Goods and Services Tax (GST) Council, the body comprising the Union finance minister and those of the states, is considering a revision in the indirect tax's rate structure. In particular, as reported by this newspaper, it is possible that the 5 per cent rate will be raised to 6 per cent. The government hopes that this will increase the effectiveness of the tax, which has been severely underperforming against the target of around ₹1.2 trillion a month. But this deficit will not be fully bridged by a marginal increase in the lower rate — after all, the 5 per cent rate brings in only 5 per cent of GST collection. While the council's intention is understandable, it is clear that this will only amount to tinkering around the margins.

GST, together with the broader slowdown, has provoked a fiscal crisis that will require careful management. Although revenue is likely to fall short by a significant margin, raising indirect tax at the moment could further dampen sentiment in the economy. The Union finance minister has assured states that GST compensation will continue to be handed out. The Union government is legally mandated to compensate states if their GST revenue does not grow by an annual rate of 14 per cent. Since this is not happening at the moment — the Union is not making payments, either — compensation arrears are building up. Without the release of the tens of thousands of crores that they are owed, states will be forced to borrow, further driving up the general government deficit and reducing the funds available to the private sector for growth and investment. On top of GST, the government imposes a compensation cess, which is meant to provide for payments to state governments, but even this has been bringing in less than what is required. As has been reported, an increase in the compensation cess is also being contemplated.

While many welcomed the flawed GST when it was introduced, that approval was conditional on the structure being improved as time went by in order to bring it closer to the ideal, efficient version. This work of rationalisation and simplification cannot be put off any longer.

Thus, what is necessary instead of further tinkering is a deeper and harder look at how to fix GST and at the government's fiscal situation overall. More fundamental problems will have to be addressed. It may be the case that, in the absence of a proper invoice matching mechanism that was planned, evasion is growing. If so, however, blindly implementing invoice matching during a slowdown may also be dangerous, given that it might significantly increase transaction costs. The GST Council must go back to the basics and recognise that the economic logic behind GST is that it would make paying taxes so easy that evasion became less widespread. This would require a simple, clear, and transparent tax system, ideally with a single rate. At the very least, rationalising all tax slabs must now be on the agenda, alongside a proper study of what a revenue-neutral, single rate would be, now that there is sufficient data from GST collection.

Pricing power

Telcos should not give up freedom to set tariffs

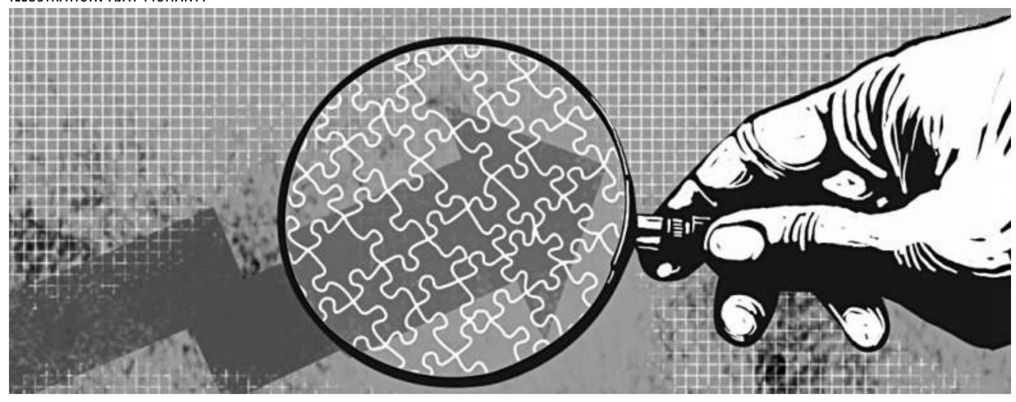
All three private telecom operators, who are rarely on the same page on any issue, have together asked the sector regulator, the Telecom Regulatory Authority of India (Trai), to set floor prices for mobile data services, while retaining voice calls under the ongoing forbearance regime. In practice since 2003, forbearance implies that telcos are free to fix all tariffs other than for national roaming and fixed rural telephony. Shifting to a floor price regime would mean no company will be allowed to offer tariffs below the mark set by the regulator. In a letter to Trai, telcos said tariff correction in the current level of fierce competition was not possible by any service provider voluntarily and, therefore, the only option available was prescribing a minimum tariff for mobile data service by the regulator.

By asking Trai to intervene, the industry is giving up its power to set tariffs for a service that is already a driving force in many ways, and will only grow in significance. That's a wrong call when tariffs are controlled by market forces across most sectors in mature economies. Any shift will be anti-consumer and against the principle of the free market. Also, the telcos' decision to seek two sets of norms — for voice and data — is flawed. In their submission, the operators have argued that unlike in the case of mobile data, voice is considered an essential service for subscribers, mainly at the bottom rung. That, according to the industry players, explains the need for voice to remain in the present forbearance regime. However, the truth is that mobile data, which enables free messaging on apps like WhatsApp, is as much an essential service as voice not just in urban areas but in rural India as well. Not only that, telcos often sell voice and mobile data packages together, and any data floor price will come with the risk of distorting the free market principle.

At a time when the industry is on a weak wicket due to the financial stress, made worse by the recent Supreme Court verdict on adjusted gross revenue (AGR) with an estimated ₹1.4 trillion demand in past dues on telcos, they must refrain from surrendering their tariff-setting power. Indeed, the duress in the telecom industry was captured in industrialist Kumar Mangalam Birla's statement last week when he said Vodafone Idea would have to shut shop in the absence of government support. While the government can step in by allowing staggered payment of the AGR dues and waiving some penalties, so that the telecom industry does not become a duopoly if not a monopoly, the regime of forbearance for tariff, both for voice and mobile data, should not be changed. There's no reason why the industry players themselves cannot be more responsible in setting tariffs. Recently, all three players raised tariffs after several years. Therefore, asking Trai to set a floor price for data seems to be an irrelevant demand.

However, this is not the first time that the industry is looking for a regulatory intervention in setting a floor price. In 2017, after Reliance Jio disrupted the market through freebies, some incumbents had sought floor prices for both voice and mobile data services. At that point, Trai rejected the proposal, saying floor price wasn't a workable idea and that prices under forbearance should continue. Trai should take a similar stand now.

ILLUSTRATION: AJAY MOHANTY



Three dangerous myths

The errors and misapprehensions that led to constant optimism about Indian growth

POLICY RULES

MIHIR S SHARMA

The kindest interpretation of the current government's actions in the years leading up to this slowdown is that it genuinely believed its own propaganda. Some have feared that its habit of concealing and denying inconvenient data while pushing forward a rosy narrative for investors and voters suggests a cynical disconnect between its analysis in private and public. But this may be untrue. What if the government genuinely believed that, all this time, the economy was a few quarters away from sustained high growth? This might raise one or two questions about their judgement and the government's in-house analytical capabilities, but it would at least clear them of the charge of duplicity.

Certainly, since 2014, there has been no dearth of optimistic voices demanding that there should be less "negativity" about the economy. Now that most such voices have been silenced, at least for now, it is worth giving them the benefit of the doubt and asking why and how one could have been misled.

Essentially, there were three big myths that many people bought into, and which helped lead us to this situation.

The first myth: The notion that the crisis of 2012-13 was over. Recall those days of "policy paralysis"? The majority diagnosis then was that the UPA government was paralysed, and its lack of policy making strength and political capital had led to a frozen economy, slowing investment, and thus collapsing growth. Thus, when a government with a parliamentary majority and enormous political capital was sworn in in 2014, a recovery from the crisis seemed assured. But that was based on a misapprehension. The problem in 2012-13 was not, in fact, policy paralysis linked to a particular administration, but a crisis of the Indian state machinery that spilled over into the private sector. Regulation was not strong enough to create both growth and transparency; poor dispute settlement mechanisms meant that capital was too gravely at risk; and suspicion about even mundane administrative actions that affected private sector returns meant that excessive caution had crept in. These problems required structural administrative reform. Some such changes have indeed been made — the Insolvency and Bankruptcy Code was among them. But, overall, the basic building blocks of the crisis were not addressed. What we are in now is not a product of that past crisis — it is the very same crisis. It was just put on the back burner, thanks to a sharp turn in the commodity price cycle, which provided a positive shock to the supply side and to government prices, between 2014 and 2016, and subsequently a recovery from an additional crisis forced on the economy by demonetisation and the botched goods and services tax (GST) implementation in 2016-17. Now that these latter two impulses have run their course, we are back in 2013.

The second myth: The notion that big-ticket public investment is sufficient for growth. This arises from several misapprehensions, including a misreading of the China model. The fact is that better infrastructure matters only if the private sector finds it profitable to use it. Thus public funding of such infrastructure only pays off if the private sector also finds itself willing and able to co-invest in the new projects that will feed off the additional infrastructure. In China, which is a state-directed economy, the private sector could easily be pushed into doing so. In India, this is less possible — and doubly so when the private sector finds itself short of funds anyway. Thus, while one might welcome the partial use of the commodity price bonanza on an infrastructure build-out from the state, the fact remains that without addressing constraints on the private sector — overcapacity, a debt overhang, tax terrorism, and stifling regulation — such infra spending would not have a "crowding in" effect. Thus the marginal product of this investment capital from the state was probably extremely low. There's no point building highways if nobody wants to buy trucks to run on them, or if there isn't enough growth in the amount of goods being transported.

The third myth: The idea of unquenchable Indian domestic demand. We had several years in which demand appeared to be solidly supporting growth. But this was a product of populist policy that (temporarily) supported income growth, household credit expansion, and positive supply side shocks thanks to a structural reduction in food and fuel inflation. None of these three factors are sustainable. Sustainable demand growth without an increase in either overall productivity or factor utilisation is difficult to envisage. The unspoken hope was that demand would keep climbing till capacity utilisation in the private sector passed some (unknown) threshold, at which the investment engine was to start up again. But it seems even if that was possible, the demand push has broken down short of such a point. The private sector is certainly credit- constrained, but nor is it feeling the need to borrow in order to finance investment projects that have suddenly become attractive. The problem here is that there has been far too much overconfidence about the size and composition of the Indian consumer economy. An economy at our level of development cannot depend merely on domestic demand to pull investment and growth up. The only true interpretation of China's growth miracle — and that of the rest of East Asia before it — is that it emerged from coupling domestic supply responses to global, instead of domestic, demand. In other words, India has to be a trading nation. Perhaps the government is right to want to protect aspects of domestic industry from the effects of trade. But, if so, its project from day one should have been to make the case that Indian development requires access to world markets alongside some reasonable and temporary protections for its infant industries. Unfortunately, it instead has fallen in love with the notion of Indian industry servicing domestic demand, and the rest of the world be damned. Naturally, this means that overcapacity will continue to plague the Indian private sector, given the impossibility of isolated and sustained demand growth.

Thus, if one is to have an optimistic view of the medium term, it will depend on whether these essential sources of negativity are removed. Structural reform of administration and factor markets is necessary in order to move on from the crisis that began in 2012-13; the quality of government spending must increase, alongside co-operation with the private sector, in order to ensure that government capital spending raises productivity and growth; and chronic overcapacity and a shortage of remunerative investment project must be alleviated by a 180-degree shift in our trade policy. If not, it is clear there is ample reason to continue to be negative.

Economy: This is as good as it gets

IRRATIONAL CHOICE

DEBASHIS BASU

The growth of India's gross domestic product (GDP) dropped to just 4.5 per cent in the second quarter of this fiscal year. For the entire year, growth will, at best, be 5 per cent. The common man is no wiser as to how, despite being ruled by a *Vikas Purush* for more than five years, growth has crashed from 7.5 per cent to 4.5 per cent. Despondency is all around, but there were hardly any cogent, official, economic arguments (other than silly sound bites from party lackeys) explaining this unexpected phenomenon. Well, official economic arguments are now available. Bibek Debroy, chairman of the Prime Minister's Economic Advisory Council (PMEAC), has written a piece in *Open* magazine, explaining what to make of the slowdown. Here are his main arguments.

1. Hey, we are still growing; be happy: India remains among the fastest-growing countries in the world. Economic illiterates (my expression, not his) talk of a recession without realising that recession, among the few things, is precisely defined in economics as: GDP shrinkage over two successive quarters. This is true, but Mr Debroy misses the point of expectations vs. reality. Did people vote for a better or a worse outcome? In 2014, did he honestly expect 5 per cent GDP growth after five years of the Modi raj? Or was it the opposite?

2. Inflation is low; be happy: Since GDP figures are adjusted for inflation, with inflation around 3 per cent, nominal growth will be 8 per cent for the year. One of the major successes of the government since 2014 has been lower inflation, which we don't seem to appreciate enough. Inflation hurts the poor more, he argues. We would have been far worse with 5 per cent real growth, 10 per cent inflation, and nominal growth of 15 per cent, he reminds us.

There are several issues here. Low inflation is an outcome of low aggregate demand. It is not an entirely independent variable. Because of various actions and inactions of the Modi government, growth — and, therefore, inflation — is down. It was an unintended consequence, which is now being touted as an achievement. There is no evidence that bringing down inflation to give relief to the poor was a policy objective. In fact, one of the often-repeated grand promises of the Modi raj was to double the farmers' income. This would have meant massive food inflation, given that India is not a significant agricultural exporter.

3. Blame weak global trade, not the government: At least 3 percentage points of GDP growth comes from exports, argues Mr Debroy. If export growth peters out, we go down to 6 per cent GDP growth. Three factors influence exports, according to him: Global demand, global supply, and the exchange rate. The government cannot do anything about the first and very little about the third. As for supply, "the Government has introduced measures to improve logistics". That's it, and so "net exports will continue to be a constraint".

If all this sounds too pat, academic, and unconnected to what is happening on the ground, it indeed is. In 2010, China's share of worldwide export of textiles was 36.6 per cent, which went down to 31.3 per cent in 2018 due to higher labour cost and other structural changes. Which countries benefited? Vietnam's share shot up from 2.9 per cent to 6.2 per cent and Bangladesh's share went up from 4.2 per cent to 6.4 per cent. India's share went down from 3.3 per cent to 3.2 per cent. Why so? Because of enormous frictional costs of doing business in India, imposed by the central and state governments. This needs to be fixed through structural reforms but that is a pointless argument, according to Mr Debroy. Please see the next point.

4. Structural vs. cyclical? It's pointless: "There is a slightly sterile debate that goes on about a structural versus cyclical diagnosis," writes Mr Debroy. Why is it sterile? Because, here again, the government is helpless, he suggests. He assumes that structural changes only mean privatisation and changes in labour and land laws. "Privatisation is a process and cannot be rushed through. Legislative changes may be necessary and one may have to go back to Parliament," while land, the most valuable asset, is typically owned by state governments; it cannot be sold by the Union government.

Land and labour are partly state subjects and the Land Acquisition Act of 2013 has raised land costs and made infrastructure projects difficult, points out Mr Debroy. The all-India growth rate is a function of what happens in state governments, according to him. The Union government cannot do much. These are straw-man arguments. Structural reforms are much less about privatisation, land, and labour, and more about expanding the scope of private enterprises and allowing them to be more competitive and productive. This should start with removing the enormous frictional cost of doing business and reducing corruption in the states. In a piece in 2015, I asked why the prime minister, who is the BJP's only vote-getter even in state elections, could not work with BJP-controlled states and show us what reforms could be achieved at the state level.

So, net-net, according to Mr Debroy, there is no gloom and doom in a 5 per cent growth rate; it will pick up to 6 per cent, but not much more and the ongoing "clean-up" will lead to a "more efficient and more formal economy", but not overnight. Mr Debroy's arguments throw very useful light on what you can expect this government to do about the slowdown — something we all are clamouring to know. The answer to that is, underwhelming: Not much.

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Supreme partisanship

BOOK REVIEW

ADAM COHEN

Brett Kavanaugh had a confirmation hearing like none other, because of the extraordinary testimony of one woman. Christine Blasey Ford, a psychology professor, told the Senate Judiciary Committee that Kavanaugh had sexually assaulted her at a high school party decades earlier. "Brett got on top of me," she said, "and began running his hands over my body and grinding his hips into me." He groped her, she said, and tried to take her clothes off. When she yelled, she said, he put his hand over her mouth. "It was hard for me to breathe," she said, "and I thought that Brett was accidentally going to kill me."

Ms Blasey Ford's testimony was precise, measured and credible. Even many of Kavanaugh's supporters thought it sounded the death knell for his nomination. "Almost all of us were saying, 'It's over,'" recalled Jeff Flake, then a senator from Arizona.

It was not over, of course, and today Mr Kavanaugh sits on the highest court in the land. How he overcame Blasey Ford's testimony — and allegations of sexual misconduct from other witnesses — is the subject of *Supreme Ambition*, by Ruth Marcus, a deputy editor of *The Washington Post's* editorial page. Ms Marcus's book is impressively reported, highly insightful and a rollicking good read. It also adds another dispiriting data point that the American Republic is seriously ailing.

Mr Kavanaugh was in many ways a perfect Republican nominee for the court. An only child from a Catholic family in suburban Maryland, he was the son of a lobbyist father and a prosecutor mother. He attended Yale College and Law School, and clerked for two Republican appeals court judges and then for Justice Anthony Kennedy. He worked for Kenneth Starr's investigation of Bill Clinton; helped in the Florida recount that brought George W. Bush to power in 2000; served in the Bush White House; and finally became a judge on the United States Court of Appeals for the D.C. Circuit. Along the way, Mr Kavanaugh married Ashley Estes, a young Texan who was President Bush's personal secretary — which helped place him in the Bush inner circle

There was, however, a dark strand running through Mr Kavanaugh's life of calculated achievement: heavy drinking. In his high school yearbook, he made a reference to "100 Kegs or Bust," and in college, his interests included the annual Tang competition, an elaborate intramural beer-drinking relay race. Law school classmates have said little about his intellectual pursuits, but one recalled, "If you had asked me who was the biggest drinker in our class I would have said Brett."

As a judge on the D.C. Circuit, a traditional farm team for Supreme Court justices, Mr Kavanaugh became a leading candidate for the court — and he pursued the prize aggressively. There was one advocate whose opinion counted most of all — Justice Kennedy, whose seat Mr Kavanaugh ended up filling. *Supreme Ambition* has made news with its report that, when he presided over Justice Neil Gorsuch's swearing in at the White House in 2017, Justice Kennedy requested a private meeting with President Trump to promote Kavanaugh for the court. If Justice Kennedy did argue for his former law clerk, it was a disturbing intervention across the lines separating the judicial and executive branches — but also a successful one.

After Ms Blasey Ford, other witnesses emerged. Deborah Ramirez, a college classmate, told reporters that Mr Kavanaugh thrust his penis in her face at a party, although she had significant memory lapses. Another late-arriving witness, the Washington lawyer Max Stier, remembered seeing Mr Kavanaugh in college exposing himself to a different woman, lending possible further credence to Ms Ramirez's account.

The most interesting part of Ms Marcus's narrative is her discussion of why, in the end, the evidence mattered so little. Much of the credit goes to Mr Kavanaugh, whose own Senate testimony was as effective, in its way, as Ms Blasey Ford's was. Kavanaugh's proclamations about liking beer were widely. But his angry insistence that he was the true victim — which took a page from Clarence Thomas's response to Anita Hill's sexual harassment charges decades earlier — shifted the momentum in his direction.

Mr Kavanaugh also had strong allies in his corner. The White House counsel Don McGahn kept the FBI on a short leash, and its decision not to interview Mr Stier — an "inexcusable lapse," as Ms Marcus notes — helped prevent a stronger case from being built against Mr Kavanaugh.

His confirmation has profound implications for the court. If he turns out to be significantly more conservative than Justice Kennedy, he could provide the fifth vote to end abortion rights or affirmative action. His arrival also means that two of the nine justices joined the court despite credible charges of serious misconduct toward women — which has done incalculable damage to the court's reputation.

There was something even more profound at stake: whether, on the most important questions, our nation is capable of putting the public interest ahead of partisanship, and whether the truth matters. The week before this book's publication date, President Trump told his 67 million Twitter followers that "the Ruth Marcus book is a badly written & researched disaster. So many incorrect facts. Fake News, just like the @washington post!" It would be hard to imagine a more persuasive endorsement.

SUPREME AMBITION
Brett Kavanaugh and the Conservative Takeover
Ruth Marcus
Simon & Schuster; $28; 482 pages