

In Conversation With

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Q1. Even with relatively low credit disbursal, a lot of the lending in India has turned non-performing and the extent of actual/possible default has been enough to suppress lending in the recent past. What is the reason for such mismanagement of the financial sector?

Ans. Well, this actually reflects a combination of forces. First is in terms of an overall broader strategy for banking. So, most developing countries have development banks which are doing long term financing for infrastructure and for strategic sectors. We had developmental banks but we got rid of them as a part of the neoliberal reforms of the 1990s. The trouble is that the jobs they performed still need to be done because we still need to fund infrastructure and LIC and these long term bonds can do only so much. So ultimately, what happened is that our commercial banks, which are in the public sector now, were more or less told to take on this. That's a fundamental problem, there's a maturity mismatch because commercial banks are not meant to do long term financing, high risk, high gestation periods and all of that. So you would expect a mess. In other words, especially in the boom period of the 2000s, a lot of the financing was through commercial banks, in infrastructure, in aviation, in all of these sectors that were seen to be growing but would take a long time to repay. And you would expect that inevitably, commercial banks would have a problem as a result. So that's one that's a structural problem. Associated with that is the whole crony stuff, which again, has two aspects. One is, of course, the straight corruption, the Nirav Modis, and that's the easy one to highlight that there are the people who are getting away with gaming the system and the other is that certain industrialists benefited much more than others, even for these aviation, coal, energy and all of these things. So, that's the second element. The third is that many of our infrastructure sectors themselves got bogged up in problems because they had been done hastily without taking into consideration all the requirements. So coal, there was this scandal over coal and a lot of coal investments simply got stalled. In fact, many mineral investments were stalled because they had not done proper environmental proceedings. A lot of the sectors in which commercial banks had lent, in which commercial banks should not have been lending anyway, had more problems because of the way in which they had been encouraged. Now the funny thing is that all this was happening during the boom period, because of which everyone was happy about it. We were the darlings of international investors but the reason we had high growth rate at the time was because we were doing all these things shoddily, we are not doing the proper procedures and so on and so forth. That's the third element of it. The fourth element is that the government didn't deal with it adequately. Default is part of the game. All credit systems have periodic defaults, it's not a big deal. What happened is that government especially UPA and the NDA(the current Modi regime) tried to shove it under the carpet until it could not catch up anymore. So, it was only when Raghuram Rajan announced that a lot of it has been misclassified as NPAs and

when he insisted that it needs to be classified correctly, there was hell to pay. So it's like you don't clean your room for weeks and when you finally clean it, you discover the dirty omelette lying under the bed.

So it was a delay. And then when they said that they would recapitalize, they gave such tiny amounts that it was meaningless. So if you're going to recapitalize, which is not the end of the world, it happens to all banking systems everywhere, China's recapitalized its bank four or five times in the last 10 years, nobody would notice, as it happens in the normal process. But if you are going to recapitalize and you need one lakh crore and if you give ten thousand crores, it doesn't work, and it actually then only intensified the problem.

So I would say it's all of those things now coming home to roost. So what happened is that because the banks had high NPL and banks anyway ration their credit, they got even more and more careful with whom they were lending to. The small and medium enterprises were just excluded completely. Among the large ones the cronies continued to get, and they still are getting, in fact, large loans. But there was a bit more wariness about who and even among borrowers, banks were increasing resiliency. The large investment rates have been falling continuously for the last six years. So where is the demand for that credit, the demand is with the medium and small, but you're not giving them because you want to give it to the big guys, they are not interested, anyway they took a lot of your money to go and buy internationally, like the TATAs and the Birlas and Mahindras and everybody but they didn't really want to do the same kind of investment.

so there is less demand for it, then you did Demonetization, which destroyed faith in the banking system for Indian people. So after that, less and less people are willing to put money in banks because they have this fear that something again will happen. And the perception is that the public banks don't allow you to withdraw money, which is the opposite of what it should be. So you now had even a stagnation in deposits. So I would say what we've ended up with is a completely unnecessary man-made mess in the banking system and I say man-made because they were men.

Q2. The share of direct taxes in the total tax revenue has continuously fallen from 38% in 2009-10 to only 32% today. Why do you think we have been unable to tax high net worth individuals and private companies which are earning a lot and due to this, we have to raise taxes through indirect taxation, which is considered much more regressive?

Ans. Well, I guess the simple answer to this is the lack of political will. It basically means that you don't want to tax the rich because you want them to fund your election campaigns and the rest of them are your cronies or your children. So basically you are not interested in taxing the rich is the first part.

The second part is the shared politics of it and the whole growth strategy, you know what we call the neoliberal growth strategy based on a particular growth model of how economy is going to work and how the development is going to happen which is that its large capital which is going to deliver for you, large capital, you have to encourage it and you have to incentivize it and you have to give them lots of goodies, so that they

will go out and invest and that Investment will give you growth and formal sector expansion and employment, it will deliver and it will trickle down, that's the philosophy. Now when you are incentivizing, that really means all kinds of things. It means that you can't tax them too much and have to effectively subsidize them in all kinds of ways, in cheap land, cheap electricity, cheap access to resources and cheap water, a cheap spectrum, you have to keep giving them things to incentivise them. It means that any attempt to tax will be seen as anti-reform and it should be the other way. So there is a systemic problem, just like in banking there was an approach, a problem of economic strategy. Similarly, with taxation, there is a problem of economy strategy. You are convinced that if you tax, capital will leave or they will not invest and then you won't get growth. Now, that is something I believe is a false idea. I believe that if you look at the successful economies in the world, even in the period when they were growing rapidly, they did tax and they used the tax revenues to fund things like infrastructure and to enable wages to increase and in other words to expand public demand. Now, that is crucial because if you don't get demand, you don't get the growth. That is why we have falling interest rates, there is no demand. If the private sector is not going to do it, that is the corporate private sector, if the ordinary people are too poor and don't have jobs then they are not going to do it either. So the public sector has to do it, it has to spend-not just for general infrastructure and services but just to generate demand. Now, if you don't have the resources for a public sector to spend, then this is not going to happen so you have to raise those revenues. Our Tax-GDP ratio, for center and state combined, is under 20% which even by Asian standards is really, really low. Forget the developed countries their tax-GDP ratio is in 50% range, most of Europe is 50% plus but even the so called "Asian Tigers" in their periods of growth are all 30% plus and it has to be, because that is how you generate all the infrastructure, all the expansion, all the growth and that brings your private investment. So I would say it is a problem of strategy, you have to undo that strategy and then it is a problem of the politics.

What about tax evasion? Why are they able to get away with it?

Tax evasion happens because we allow it. Its political will. This is the whole Laffer Curve thing, you lower the tax rate and the compliance goes up and honestly, I have always found that very foolish because paying zero tax is always preferable than paying a low tax. So if you can avoid, you will. The notion that people don't pay just because it is high and if it goes down by 2% suddenly they will start paying-no. They pay their taxes because there are consequences if you don't. That is how all societies function. In India, we have a very oppressive tax administration for all kinds of irrelevant people but the people who are actually cronies can get away with the matter. Precisely because there are several ways in which you can get away with it. One way is straight forward tax evasion-you don't report your income and the other is tax avoidance or what is called tax planning strategies by the corporates, you utilise every loophole. We have given away 6.5% GDP in tax breaks in the budget every year. So you can utilise all of those to avoid taxes. The evasion, is basically a reflection of our poor tax administration. In demonetisation, the final last straw they clutched at was the now there are all these people who are in the loop because they put money in 2.5 lakhs or whatever the limit was so we are going to trace them. So I was talking to this guy who is a tax officer and he said that it will take 150 years, if all of our available manpower is

working only on this, full time i.e. on tracking all those people. But are they doing that? No. What are they doing, for example, I have been audited six times in a row, it is absolutely crazy and they can do it for up to ten years before and when they audit, you have to find every single receipt so I have four different files from the last ten years because they can ask anything. And the purpose is always to harass you till you say okay, I will give you 10,000 but please now, leave.

Q3. According to the Swaminathan Commission, the MSP should be calculated by C2 (ie including the imputed cost of rent and interest on capital owned along with labour and paid out cost). The governments since 2006 have repeatedly ignored this recommendation and key demand by farmers, calling it unfeasible. What is your opinion on it? Also, keeping in mind various problems such as long delays in payments to farmers and the large transaction costs that farmers incur due to multiple registrations, how, according to you, can the government ensure MSPs to farmers?

Ans. The problem is not about just whether it is, you know, A2+FL or C2, the actual problem is how do you ensure that MSP function is the floor and there, the whole procurement system is actually the problem. First of all, we effectively grow 2 crops-wheat and rice. We are supposed to grow 32 crops and most of them are not really covered. Second, even in those, the procurement is done only in certain states because it was designed as a system to would transfer food grains from areas of surplus to areas of deficit. So it is all about the collection in surplus areas and distribution in deficit areas. The trouble is that now you want to make that the minimum support price so you should be going everywhere but you don't go to deficit areas . Even in the surplus areas, you go late, you don't go just immediately after the harvest, you stay there only for two days in a particular haat or a Mandi, you are not there enough for the farmers to get their stuff across and there are all kinds of things so there are many, many problems with the way the procurement operates. But that is just one part of the whole problem. I was involved in a farmers commission in Andhra Pradesh way back in 2004. And they all were of course, jumping up and down about this whole, procurement price. It was in fact in cotton, the official procurement price in that state, They said it was C2 plus not 50%, but some 30% or whatever, but it was still below their own cost of production. Because remember, the CACP looks at the Indian average. So it takes the Indian average across all states and they are taking one C2 and that C2 varies massively across states. Now, when you ask them why don't you have different values for different states, the most sensible response that comes is that if we did that, the state that should not be producing a certain crop will start producing it which is not efficient and you are encouraging people to do costlier things. Now Andhra Pradesh is a particular case where farmers have really went commercial very very quickly and they went commercial even on the inputs. The farmers were constantly buying new seeds, fertilisers new chemicals more this and that very very heavy use of pesticides, six times the recommended avionic rate for cotton to the point that it couldn't be sold anymore. So they were overdoing it. So is that a failure of procurement? No. That is a failure of the extension services which have not been explained properly to show the farmer that this is not the best way to cultivate the crop cotton. So it is a very complicated thing to look at the problems of farmers only through the lens of MSP is a mistake.

And it is basically a rich farmer demand So they are the only ones who really benefit from it and where is the procurement for onions and tomatoes and horticulture culture of any kind, even for the oil seeds, there is no real procurement for soybean and all of these things. So I would say that to make procurement effective - first of all you have to make that system more effective which means you need to put money in it and allow decentralized procurement which basically means giving state governments more power, and let state governments give more power to the districts, the panchayats, then you can even start procuring the traditional staples. So you can do all that If you decentralize and if you put money into the storage facilities, local procurement and enabling that to happen.

Q4. As an undergraduate student of economics, what prompted you to choose or study economics as your subject?

Ans. I actually studied sociology as an undergraduate because I was interested in society and I think we were one of the first sociology batches in Miranda House. And I did Sociology because I was always interested in society and I wanted to know how things change and social trends develop. And then the more I studied Sociology, the more I realized that it's economics that's determining it. In other words, I got more and more persuaded that I was looking at the surface of things and the things that were happening, the property relations, economic policies, the nature of employment was driving things on top. So I then switched to economics which was tough, and fortunately, in those days, JNU did not require an undergraduate degree in economics. I got in, and I have to tell you that the older I get the more I realize that every economist must be made to study Sociology. That so much of economics is determined by socio, you know, so in a way, I have kind of come in a full circle. I now think that economists need to study sociology and politics.

Q5. What do you think about this 10% reservation for the urban?

Ans. It's a joke. It's political, but do you think that the electorate is that stupid? Because look at it, it's eight lakhs, I mean my daughter qualifies. Effectively, 99% of the population is below this. But 90% of your upper castes, would qualify. That's number one. That's such a large kind of thing. Effectively, everybody qualifies, number one. And number two, 10% of 0 is still 0. Public employment is not growing. It's a constitutional amendment and you are rushing it in one day. It's done overnight, Everything is done at night and it has landed it in a mess.

Q6. What do you think are the steps the government could have taken and future governments should take to increase jobs in our country?

Ans. The first one, I would say, definitely, is a massive increase in public employment. Now there is a belief that public employment means government jobs, means Babus and everybody thinks, "Oh God, not yet another Babu picking their nose and sitting in the sun." So there is a negative approach to government jobs. But think about it, who are the people who are mostly employed in most states across the world? In education, in health, in sanitation, then basic infrastructure and they are in services to assist people, you know? Those are actually very necessary. We under-provide them, we don't provide them to our citizens. We don't provide them with any of the basic things they need.

Now, spending on these is very labor intensive, so it has high multiplier effects. So if you spend on health, then it has very high multiplier effects. You are going to generate multiplies of three or four multiples. People you hire are going to go out there and spend their wages. And that in turn, generates secondary incomes. So private activity will come up if you look at the multiplier effect. Around 2010, or maybe even earlier, so if you look at the ratio of public employees to population and you take that as a proxy for the kind of services you deliver, the global average is about just under four. Europe is 6, The United States was 5, and Sweden, Nordic countries, were about 11 to 13. And you know that they give proper services, India less than two, Africa, 1 and that figures, you know? And that means everything. That's why you have long queues, because you are under-staffed, and that's why you have poor quality service. You go to a public hospital, and you have to wait all day to see a doctor because they are under staffed. And the nursing is terrible because you are under staffed. And so on and so forth. So public employment is a huge increase in welfare, obviously, but it's a huge employment generator. It actually creates secondary jobs. Now what do we do instead? We want to do a big national health program instead with Ashrams, who have got volunteers, so they don't have to be paid the minimum wage. You get 500 a month and in some states you get 1500 a month.

Number two, I would say as an immediate measure the employment guarantee, NREGA. It was the deputy director of the ILO, I was with her in a panel in Argentina recently, and she began her presentation by saying that the NREGA is the most innovative policy, no the most significant policy innovation of the 21st century. They started well, but they let it fizzle. They're denying it funds, they aren't letting it work. But if you use it properly, it has so much potential, it can improve the quality of life, you don't have to confine it to earthwork and digging. Those are important, you can do surface inflation, you can do drainage, you can do so many things, you can link it to care. There's no care at all, if you are destitute and elderly, you are out. You can link it to so many things that would improve quality of life and you can generate multiplier effects. There is a strong case for an urban employment guarantee and an expansion of the rural one. And it will pay for itself because you will get more tax revenue from the increased economic activity. So that's number one. Second is, where are all the jobs? They are in the MSMEs. Frankly, it is a miracle that any one of them can survive. They don't get credit, they don't get proper electricity, I mean they constantly have to pay every single person that comes along. So if you just have a very basic package for MSMEs access to credit, access to basic infrastructure, providing help with marketing, the kinds of things you get in every other country. You do that, and you're home already.

