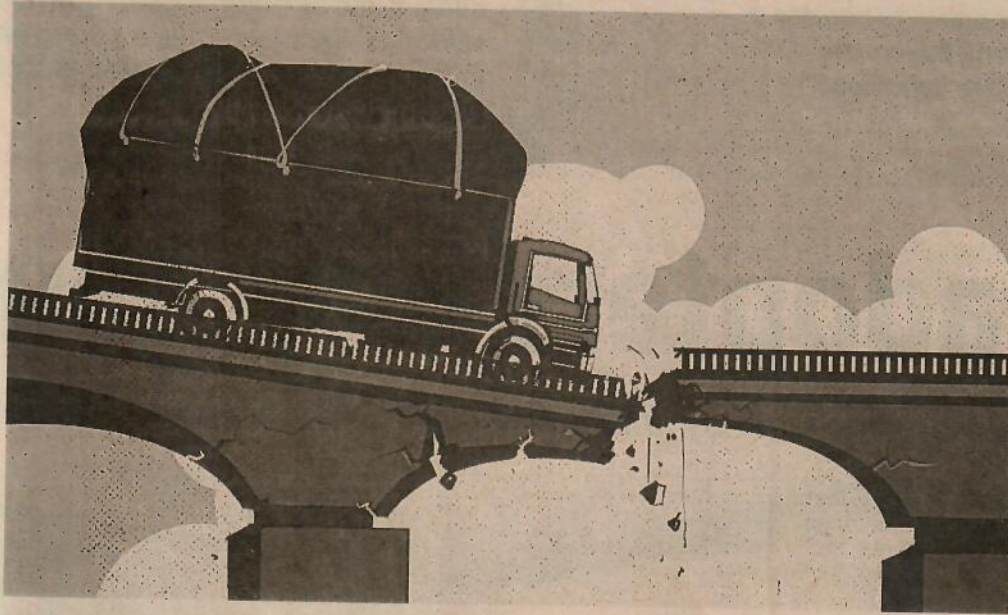


ILLUSTRATION BY AJAY MOHANTY



Beware of premature load bearing

Our fledgling systems face a new level of stress both from big cases of insolvency and the GST. We run the risk of an organisational rout

When a bridge is weak, and a heavy truck tries to ride on it, the bridge collapses. We must be mindful of load-bearing capacity in public administration. We should cautiously introduce small loads, and increase the load only after we are confident that the systems are capable. The design of the GST that's being attempted, with high rates and complex rules, is a big load that's being sent into a weak system. The 12 big companies that are being sent into the new bankruptcy process are a big load that's being sent on to a fledgling system. We risk organisational rout.

We should learn to walk before we can run. This simple idea has far-reaching consequences for public administration. Every government system has a certain capability. If we ask a weak system to handle a big challenge, this tends to collapse with pervasive corruption and lack of enforcement (see <https://goo.gl/FXYNFW>).

Consider a government office that manages land titles. Suppose it is able to handle a load of 50 transactions a day. Suppose 500 transactions happen each day. This is going to generate an 'organisational rout' with an ever-extending backlog, chaos, and corruption. The load in this case is measured by transactions per day.

There are two other dimensions of load in public administration: How much discretion do officials have, and what is at stake? The hardest systems in public administration are those that involve high

stakes, where officials have the discretion, and the number of transactions is large. A school teacher who does not show up at work only steals ₹10,000 a month: The stakes are low. A corrupt judge or policeman or tax officer, in contrast, makes crores of rupees as the stakes are high.

Load bearing in the bankruptcy reform

What is load in the bankruptcy process? In a defaulting firm, a loss has taken place in the past. The bankruptcy process allocates the loss. The stakes are the highest with big bankruptcies. The persons who face large losses owing to the working of the bankruptcy process will hire high-powered legal teams, and spend money on all means fair and foul, to push the loss to someone else.

What gives load-bearing capacity in the bankruptcy process? The basic architecture of the Bankruptcy Legislative Reforms Committee (BLRC) is capable of high loads. Load-bearing capacity now comes from six things: (1) building a sound Insolvency and Bankruptcy Code (IBC), (2) building a sound Insolvency and bankruptcy Board of India (IBBI), (3) run a sound regulation-making process at the IBBI and draft high-quality regulations, (4) building a sound profession of insolvency professionals, (5) building a sound industry of information utilities, and (6) and building a sound National Company Law Tribunal.

When all six elements were fledgling, it made

sense to put small test cases through the new bankruptcy code. Roughly 100 small cases have begun, which is a good thing. As they go through the process, numerous flaws will be identified. A talented team is required to rapidly diagnose the failures of the system, and rapidly solve them. This team has yet to be created.

So far, not even one case has come out at the finish line, so we should be tentative in our assessment of the load-bearing capacity. Many flaws are visible which are not being addressed. Under these conditions, the entry of 12 big cases makes me nervous. Big cases are the highest load. This will place a new level of stress upon our six fledgling systems. We run the risk of an organisational rout.

Once a big case has started on the IBC journey, there is no turning back. The wise course now would be to build a talented team that will carefully watch every step that takes place with the 100 small cases and, particularly, the big ones, rapidly solve problems as they become visible, and build the six elements of load-bearing capacity. In addition, it would be wise to not undertake premature load bearing, i.e. bring additional big cases into the IBC, for the next year or two while the six systems are as yet unproven.

Load bearing in the GST

What is load in a GST? When the tax rate is high, the incentive for evasion goes up, which increases load. Multiple rates create opportunities for arbitrage through mis-classification. If ice cream has a high rate and yogurt has a low one, producers will surely sell ice cream mixed with a bit of yogurt under the garb of yogurt. This increases the demand upon enforcement capability, while giving more discretion to officials. The GST involves more load when there are multiple administrative authorities.

What gives load bearing in the GST? We need a unified Central Board of Taxes (CBT) that triangulates between corporate income tax and the GST. This needs to be backed by a strong database and research capability. The CBT combines legislative, executive and quasi-judicial branches. It must be grounded in a Tax Administration Act that sets out sound processes for the three processes. It needs sound reporting and accountability mechanisms, and oversight by a board with a careful design of composition and powers (see <https://goo.gl/oR6W1G>). The CBT must be the only tax administration seen by firms operating in more than one state. The GSTN and e-filing are on the right direction. But a thin layer of computerisation cannot substitute for deep public administration reform.

In the Indian GST reform, we have embarked on the highest possible load. At the same time, we lack load-bearing capacity. We run the risk of an organisational rout (see <https://goo.gl/DTDve3>).

In the case of the bankruptcy reform, the basic BLRC architecture is sound, but the implementation is faulty. The solution is visible in the form of one talented team. In the case of the GST, the basic architecture of GST policy and administration is broken, so the journey for the Ministry of Finance is harder.

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SNAKES & LADDERS

AJAY SHAH