

DON'T REDUCE THE FIGHT AGAINST CORRUPTION TO A MORALITY PLAY

Relevant for: Ethics | Topic: Challenges of corruption

A failure to consider the economic dimension of the problem may be a factor in India's slowdown

The ongoing slowdown in growth has many underlying causes, both domestic and external. However, if one were forced to choose just one domestic cause, it might well be an intangible one. The key causal factor connecting all other contributory factors to the slowdown is probably the Narendra Modi government's decision to treat corruption, black money and tax avoidance as a purely moral problem and not an economic one. When corruption is painted in such black-and-white terms, the solutions also tend to be driven by morality concerns. But systemic corruption is seldom a purely moral issue. It is embedded in long-term practices that may be ingrained in the social fabric. Trying to eliminate these practices too quickly may lead to negative economic outcomes. This is what we may be witnessing right now.

It may not be entirely the government's doing, for the anti-corruption hysteria started building up after the unearthing of the 2G and coal block allocation scams, which saw a popular movement led by Anna Hazare, Arvind Kejriwal and Kiran Bedi capture our collective consciousness. In the fire-and-fury of the movement, all businessmen were painted as crooks. Post-2014, the Congress party tried to pin the same label on the Modi government, with Rahul Gandhi making his (in)famous "suit-boot-ki-sarkar" jibe in Parliament.

Given this backdrop, it is hardly surprising that the government saw corruption and tax compliance as some kind of moral "dharma yudh" and not an economic issue that needed sensible and steady long-term measures.

We saw the impact of this moral attitude in the anti-corruption schemes that followed. First, we had an amnesty scheme for foreign assets and incomes, where the penalties were so extortionate that almost no disclosures were made. This was followed by two domestic black money disclosure schemes; one before demonetization and the other in the midst of it, where too the penal taxation rates were too high. The failure of these schemes to garner adequate disclosures and tax revenues testifies to the reality that even crooks weigh the need for compliance based on calculations of costs and benefits: the costs of disclosing black money and paying high taxes against the benefits of keeping the money with them. Then we also had the benami transactions prohibition law, which probably impacted real estate transactions, too.

The decision to pursue the extradition of Vijay Mallya in UK courts for his Kingfisher loan defaults (as opposed to recovering what was possible through negotiations), the fraud investigations launched against many private and public sector bankers, and the aggressive attempts to enforce tax compliance in general could not but have had a negative impact on economic sentiment.

The net effect of all these developments would have been the following: Illegal wealth, whether held abroad or at home, would have got frozen substantially in tax havens and unproductive assets, instead of freely flowing through the economy. Any major clampdown on corruption and black money will dampen economic activity in the short to medium term, for it crimps decision-making, consumption and investment. If you have hoards of cash, and the climate is that of suspicion, it is more than likely that you would slow down ostentatious or even regular spending.

This climate of suspicion prevents bankers from lending and regulators from making sensible decisions (for example, on reducing high spectrum prices). Even the government is paralysed by fear of being labelled “pro-business” in case concessions are offered to any beleaguered sector.

Put another way, reducing corruption to a morality play has impeded the government’s ability to quickly fix the telecom, coal and real estate sectors.

Now, consider a counter-factual. We know that last September, the government drastically cut corporate taxes to 15% (plus surcharges) for new manufacturing units, and to 25% for the rest—something that was promised as far back as the 2015 budget, which preceded those black money amnesty schemes. Consider what kind of schemes would have been framed if these rates had been cut in 2015 instead of 2019. At the very least, it would have enabled the government to bring down the penal provisions in those amnesty schemes, enabling a larger inflow of disclosures and taxes paid.

If we assume that high tax rates lead to higher evasion, it follows that keeping tax rates high makes crooks out of businessmen who might otherwise have complied. By implication, we are saying that tax evasion is a function of what we define as crookery.

The assumption that tax evasion must be punished heavily is driven by our moral sense that they must not be seen as benefiting from their efforts to diddle the taxman. But if we keep the threshold for defining an economic act as a crime too low, too many people will become crooks and tax evaders for minor offences.

The purpose of law is to try and keep the definition of an economic crime at a threshold level where most people will accept that it is a crime, and not at a level where evasion is seen as necessary to make an economic activity viable and profitable.

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